2004 ANNUAL REPORT

BALANCING RISKS | REAPING REWARDS

FAIRBORNE ENERGY LTD.

ANNUAL MEETING

The Annual General and Special Meeting of the shareholders of Fairborne Energy Ltd. will be held at 3:00 pm (MDT), on Thursday May 26, 2005 in the Penthouse Suite of the Fairmont Palliser Hotel, 133 Ninth Avenue S.W. Calgary, Alberta.

A FOCUSED ENDEAVOUR

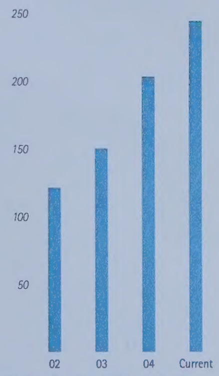
CONTENTS

HIGHLIGHTS AND ACHIEVEMENTS

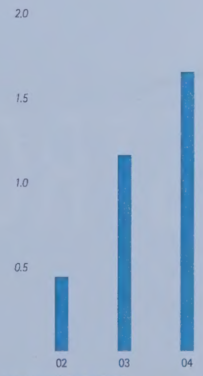
2004 SUMMARY

(Years ended December 31) (units as noted)	2004	2003*	% change
Financial			
Petroleum and natural gas revenue ($000)	125,604	51,159	146%
Funds generated from operations ($000)	66,399	29,151	128%
Per share - basic	$ 1.65	$ 1.16	42%
Per share - diluted	$ 1.54	$ 1.10	40%
Net income ($000)	13,702	10,322	33%
Per share - basic	$ 0.34	$ 0.41	(17%)
Per share - diluted	$ 0.32	$ 0.39	(18%)
Exploration and development expenditures ($000)	135,174	34,496	292%
Acquisitions, net of dispositions ($000)	168,988	45,883	268%
Working capital deficit, including bank debt ($000)	98,058	9,371	946%
Shareholders' equity ($000)	247,777	86,201	187%
Common shares outstanding (000)	49,902	32,328	54%
Operating			
Average production			
Natural gas (Mcf per day)	31,116	10,640	192%
Crude oil (bbls per day)	2,593	1,850	40%
Natural gas liquids (bbls per day)	309	164	88%
Total (BOE per day)	8,089	3,787	114%
Proved and probable oil and gas reserves			
Natural gas (Bcf)	163.0	46.9	248%
Crude oil (Mbbl)	9,006	5,397	67%
Natural gas liquids (Mbbl)	2,393	606	295%
Total (MBOE)	38,558	13,811	179%
Netback ($ per BOE)			
Petroleum and natural gas sales	42.42	37.01	15%
Royalties	8.96	6.83	31%
Operating expenses	7.95	6.25	27%
Operating netback	25.51	23.93	7%
Wells drilled (gross)	109	30	263%
Undeveloped land (net acres)	230,422	115,318	100%

* *Restated due to change in accounting policy with respect to Asset Retirement Obligations*



PRODUCTION GROWTH PER SHARE
(BOE/day/mm share)



CASH FLOW PER SHARE
($/share)

STRONG | PERFORMANCE

2004 was a very good year for Fairborne's shareholders. Share value is up 145 percent from the year ended 2003 reflecting strong per share growth in production, reserves and cash flow.

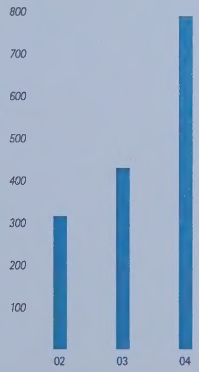
REPORT TO SHAREHOLDERS

TO OUR FELLOW SHAREHOLDERS

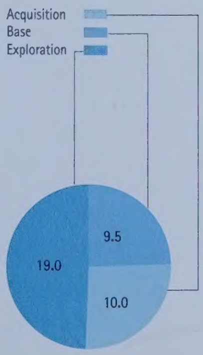
I am pleased to report that 2004 was a very good year for Fairborne shareholders. At this writing, Fairborne's share value is up 145 percent from the year ended 2003 reflecting strong per share growth in production, reserves and cash flow.

The growth theme in 2004 centered on exploitation of two strategic acquisitions and drilling successes in four different areas. The acquisition of several properties from BP Canada on March 31, 2004 for a price of $112 million strengthened Fairborne's position as a natural gas producer and added 96,000 undeveloped acres of land, significantly expanding our inventory of exploration and development opportunities. The corporate acquisition of Case Resources Inc. in July, financed through a share exchange, added properties directly contiguous to our existing core areas in central Alberta and substantially increased the Company's coal bed methane ("CBM") acreage position.

The major highlight of 2004 was the success our strong technical team had with the drill bit. Our 109 well drilling program achieved a 94 percent success rate. We added 19 million BOE of proved plus probable reserves at a cost of $7.12 per BOE without future capital and $9.73 per BOE including future capital. Including the aforementioned acquisitions, the Company's total proved and probable reserves after production and minor revisions, increased 179 percent over 2003 from 13.8 million BOE to 38.6 million BOE an increase of 83 percent on a per share basis. The total cost for finding, development, and acquisitions was $10.98 per BOE ($12.76 per BOE with all future capital) and we replaced our 2004 production by 836 percent.



RESERVES GROWTH PER SHARE
(BOE/000 shares)

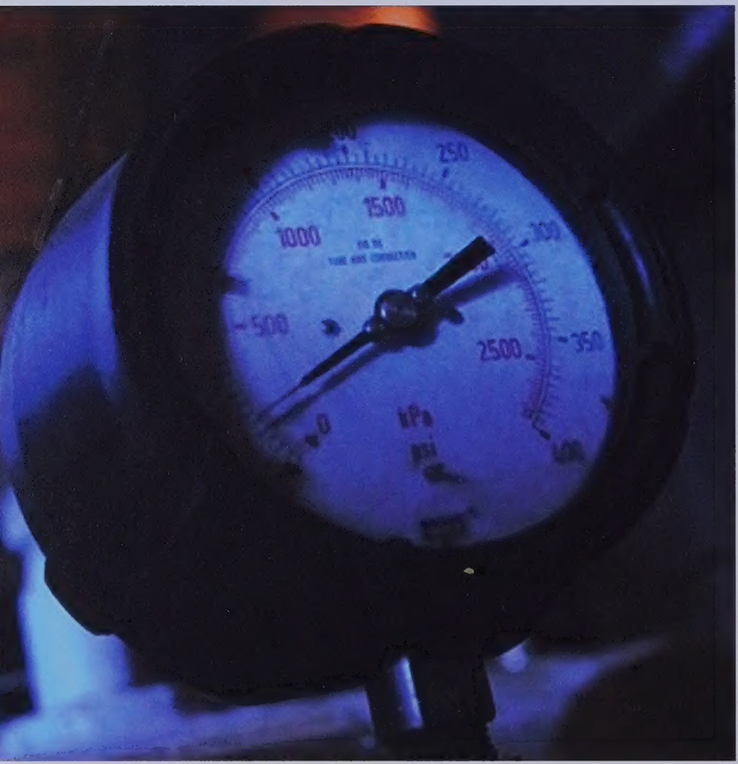


RESERVE ADDITIONS
(MMBOE – P+P)

GROWTH AREAS

In my 2003 report to the shareholders I stated "Our competitive advantage is based on our geographic and geological focus, our operational control and the risk management of our prospect portfolio. With a large inventory of exploration and development opportunities we have the advantage of choosing from a range of reward and risk. This balance will be the key to our success." It appears that we chose well in 2004.

Our drilling success occurred over a broad risk spectrum. Deep high risk targets were successful at Wild River; medium depth and modest risk targets were successful at Columbia/Harlech and Westerose; and shallow, low risk gas in Horseshoe Canyon Coals at Clive went into commercial production. Moreover, the two acquisitions in 2004 coupled with acquisitions of Crown lands at public sales and farm-ins with industry partners have created a prospect inventory that now includes over 300 drilling locations, which will require $350 million of future capital net to Fairborne.



At Wild River, the Company started production from a Nisku reef discovery (at 3,800 meters) in September. The well has produced almost 2 BCF of sales gas (1.0 BCF net to Fairborne's interest) since beginning production. We are currently drilling a similar test nearby and have additional opportunities identified on seismic for future drilling. We now have over 1,500 square km of 3D seismic in the Wild River/Lambert/Deep Basin Area with 21,205 acres (net) of undeveloped land.

At Columbia/Harlech we have drilled 16 wells (10.4 net wells) since August 2004 with 11 wells currently on stream producing approximately 1,400 BOE/d. The targets are primarily gas bearing, Cretaceous sandstones ranging in depth from 1,600 meters to 3,200 meters. These are opportunities that sit in the middle of our risk/reward portfolio. We have an additional 45 defined drilling locations on Fairborne lands in the Columbia/Harlech area.

At Westerose we placed four gas wells on production in the fourth quarter of 2004. These wells produce from Lower Cretaceous sandstone reservoirs at a depth of 1,300 meters to 1,400 meters. We plan to drill eight additional wells for these targets as well as five deeper gas tests into an upper Devonian reservoir at approximately 2,000 meters.

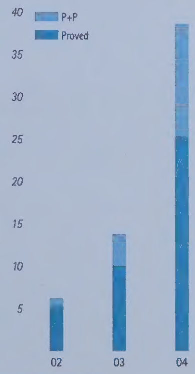
REPORT TO SHAREHOLDERS

During the year, at our Clive property in Central Alberta, we started the first full scale development of gas from Horseshoe Canyon coal seams. To date we have 48 wells on production at a combined rate of 7.4 MMcf/d (6.9 MMcf/d net) or 154 Mcf/d on average per well. This CBM project is our lowest risk development in our large portfolio of gas drilling prospects. We have 150 additional wells to drill over the next two to three years.

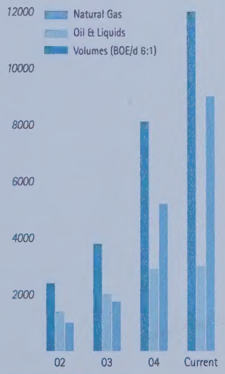
Although the technology employed in Clive to produce gas from coals is vastly different than that used in our deep sour gas plays, our professional and technical staff has demonstrated exceptional versatility in successfully developing these diverse and challenging assets.

PROPOSAL TO REORGANIZE FAIRBORNE

On March 9, 2005 the Company announced that its Board of Directors had unanimously approved a proposal to create a new oil and gas trust, Fairborne Energy Trust, and a public exploration-focused junior producer called Fairquest Energy Limited. Pursuant to a Plan of Arrangement, Fairborne shareholders will receive, for each outstanding common share of Fairborne, one third of a common share of Fairquest and, at their election, either one unit of Fairborne Trust (which will receive monthly cash distributions) or one exchangeable share (the exchange ratio of which will be adjusted on a monthly basis in lieu of cash distributions to unitholders) in an affiliate entity, such shares being exchangeable into a trust unit of Fairborne Trust.



RESERVES GROWTH
(MMBOE)



PRODUCTION GROWTH
(BOE/d)

Fairborne Trust will own 90 percent of the existing producing assets of Fairborne. With an anticipated enterprise value of approximately $700 million, the Trust will have production of approximately 11,000 BOE/d, proven plus probable reserves of 35.6 million BOE, a proved and probable reserve life index of 10 years, 168,000 net acres of undeveloped land and 73 percent of production will be natural gas.

Fairquest will acquire working interests in certain of Fairborne's producing assets and undeveloped land in the Columbia/Harlech, Peace River Arch, Pine Creek, Wild River and West Pembina properties. These interests currently produce approximately 1,000 BOE/d with proven plus probable reserves of 3.1 million BOE. Fairquest will also have approximately 68,000 net acres of undeveloped land in these core areas. In addition, Fairquest will have the right to farm-in on 83,000 net acres of Fairborne exploratory lands retained by the Trust. This exposure to over 150,000 net acres will provide Fairquest access to a rich and balanced inventory of opportunities.

REPORT TO SHAREHOLDERS

This proposed reorganization is designed to enhance shareholder value by separating certain lower risk assets to create a platform for optimization and stable distributions for the Trust and at the same time create a new growth-oriented junior producer. Shareholders of Fairborne will have the opportunity to participate in the future of both entities as a result of this transaction.

The separation of the longer life producing assets from the exploration, higher risk growth assets better aligns the risk and return from each asset class and provides shareholders the opportunity to determine their participation in each asset class. For example, the trust will have a substantial CBM project with an additional 150 low risk locations to be drilled and placed on production. We anticipate the Trust will have production of approximately 11,500 BOE/d by year-end 2005 while spending only about 40 percent of the cash flow with 60 percent distributed to unit holders in a tax efficient manner. Fairquest, on the other hand, provides shareholders with a ground floor investment in a high growth, exploration focused company. Fairquest shareholders retain exposure to a substantial portfolio of identified drilling opportunities.

L-R: Robert A. Maitland, Vice President, Finance and CFO,
Richard A. Walls, President and CEO,
Steven R. VanSickle, Senior Vice President, Exploration and
David L. Summers, Vice President, Operations and COO

Both the Trust and Fairquest will be managed by the same experienced team of professionals who have demonstrated their ability to deliver on exploration, exploitation, acquisitions and financial management objectives. As a result of this reorganization the executive team of the Trust will be comprised of the same team currently at Fairborne except that I will move to the non-executive Chairman of the Trust and Steven VanSickle will become the new President and CEO of the Trust.

Fairquest will be led by myself as President and CEO and Robert Maitland will become the VP of Finance and CFO. Fairquest will have access to all of the employees of Fairborne Trust pursuant to a Technical Services Agreement. The majority of directors of Fairquest will be independent of Fairquest and the Trust.

REPORT TO SHAREHOLDERS

We anticipate mailing the Information Circular on the proposed reorganization to shareholders in April with a special meeting of shareholders to consider the reorganization occurring in late May. The Plan of Arrangement will require the approval of 66 2/3 percent of the votes cast by the shareholders and option holders of Fairborne voting at the meeting, the approval of the majority of the shareholders excluding certain related parties, the approval of the Court of Queen's bench of Alberta and of certain regulatory agencies.

OUTLOOK

Upon successful closing of the corporate reorganization in late May we anticipate that the Trust will spend approximately $25 million from June until year end. This will include additional CBM wells at Clive and development wells at Westerose, the Peace River Arch and Brazeau River.

Fairquest will spend approximately $25 to $30 million during the same period. Fairquest will focus approximately 50 percent of the expenditure in the Columbia/Harlech and Brazeau River Areas.

The success of the Trust will be based on a balanced approach to the development opportunities in its portfolio. Particular emphasis will be placed on the timely development of the CBM assets at Clive. CBM production from this property has been remarkably stable to date with little to no decline from existing wells.

Fairquest will manage risk and reward much the same way as Fairborne has done for the past three years. It will have a large inventory of opportunities from which to choose and a talented technical team which has proven it can produce the results.

The major highlight of 2004 was the success our strong technical team had with the drill bit. Balancing risk & reward is challenging & it works!

Once again I would like to applaud the accomplishments of our talented staff at Fairborne and thank all of our shareholders and stakeholders for their support.

Richard A. Walls
President and CEO,
March 31, 2005

THE RIGHT DIRECTION

"With a large inventory of exploration and development opportunities we have the advantage of choosing from a range of reward and risk. This balance will be the key to our success." It appears that we chose well in 2004.

REVIEW OF OPERATIONS

Our strategy remains the same, to focus exploration and development activity in areas that offer a balance of risk and reward. These areas are characterized by multizone potential, high working interest, operated lands and both shallow low-cost and deeper high potential prospectivity.

2004 HIGHLIGHTS

- Oil and natural gas production more than doubled in 2004 to average 8,089 BOE per day from 3,787 BOE per day in 2003 (an increase of 40 percent on a per share basis).
- A 109 well drilling program achieved a 94 percent success rate and contributed to significant gains in production and reserves.
- Total proved plus probable reserves, after production and revisions, increased 179 percent over the previous year from 13.8 MMBOE to 38.6 MMBOE (an increase of 83 percent on a per share basis).
- The Company added these reserves at a finding and development cost of $7.12 per BOE without future capital and $9.73 per BOE including future capital and at a finding, development and acquisition cost of $10.98 per BOE without future capital and $12.76 per BOE including future capital.

Welding out an eight inch gas pipeline at Columbia/Harlech

- The Company replaced its 2004 production by 836 percent.
- Select property and corporate acquisitions strengthened the Company's position in its core areas of operations resulting in increased production, cash flow and an expanded inventory of exploration and development opportunities.
- Acquisition of properties in West Pembina effective March 31, 2004 strengthened Fairborne's position as a natural gas producer (natural gas is currently 75 percent of production).
- Two major gas development projects (Columbia/Harlech and Clive coal bed methane) began in 2004, with current combined production of 14 MMcf per day.
- Corporate acquisition of Case Resources Inc., financed through a share exchange, added properties directly contiguous to the Company's existing core areas in central Alberta and increased the Company's coal bed methane acreage position.

REVIEW OF OPERATIONS

2005 UPDATE

- Current production is approximately 12,000 BOE per day, an increase of 48 percent over 2004 average production.

Deep drilling rig at Columbia/Harlech

- A total of 16 (11.7 net) wells have been drilled to date in 2005 resulting in 12 (9.0 net) gas wells and 4 (2.7 net) oil wells.
- We currently have 48 coal bed methane wells producing 7.4 MMcf (6.9 net) per day.
- Recent production additions are the result of exploration discoveries in the fourth quarter of 2004 and include wells at Columbia/Harlech, Brazeau and the Peace River Arch.
- Activity will continue at a number of locations through breakup including deep exploration tests at Pedley (5,100m Leduc target), Brazeau (3,000m Mannville target), Wild River (3,800m Nisku target) and Saddle Hills (3,600m Wabamun target).
- An expansion of the Columbia/Harlech complex has been completed and is operating at approximately 7.0 MMcf per day, net to Fairborne.
- During May 2005, Fairborne's production will be affected by scheduled maintenance projects at two facilities, resulting in May production being reduced by approximately 4,500 BOE per day for 18 to 21 days.

DRILLING ACTIVITY

Fairborne drilled 109 gross (85.2 net) wells in 2004 with a success rate of 94 percent, compared to 30 gross (25.1 net) wells drilled in 2003 with an 87 percent success rate. Of the 109 gross wells drilled in 2004, 27 percent were classified as exploration wells and 73 percent were development.

REVIEW OF OPERATIONS

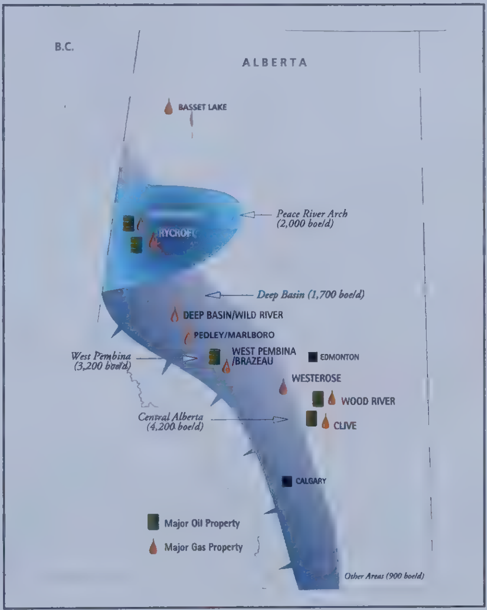
Wells Drilled

	2004		2003	
	Gross	Net	Gross	Net
Natural gas	100	77.2	20	17.0
Oil	3	3.0	6	5.0
D&A	6	5.0	4	3.1
Total	109	85.2	30	25.1
Success rate	94%	94%	87%	87%

UNDEVELOPED LAND

In 2004, Fairborne continued to expand its land holdings in core areas. The Company's total land position at December 31, 2004 consisted of 318,206 net acres compared to 173,640 net acres at the end of 2003. Land additions during 2004 occurred primarily in the Company's Columbia/Harlech and Brazeau core areas.

The Company's undeveloped land holdings increased 100 percent from the prior year to 230,419 net acres at December 31, 2004 compared to 115,318 net acres at the end of 2003. Fairborne has an average working interest of 67 percent in its undeveloped land base.



With an even larger portfolio this year — balance is still key to our success.

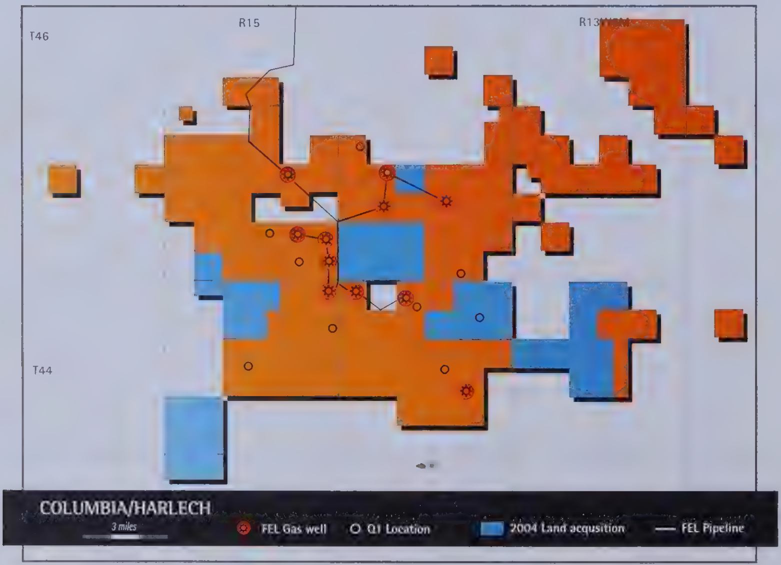
Acres	Undeveloped		Developed		Total	
	Gross	Net	Gross	Net	Gross	Net
Central	46,285	34,740	52,986	35,658	99,271	70,398
Deep Basin, Alberta	90,240	53,755	11,040	5,145	101,280	58,900
Peace River Arch, Alberta	84,800	56,370	58,287	26,088	143,087	82,458
West Pembina, Alberta	113,440	81,778	28,800	17,833	142,240	99,611
Saskatchewan	3,625	2,571	3,578	2,726	7,203	5,297
Other	4,961	1,205	1,362	337	6,323	1,542
Total December 31, 2004	343,351	230,419	156,053	87,787	499,404	318,206
December 31, 2003	157,660	115,318	100,811	58,322	258,471	173,640
December 31, 2002	24,554	19,424	38,663	22,670	63,217	42,094

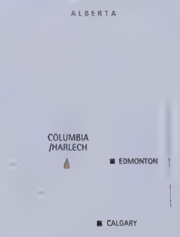
REVIEW OF OPERATIONS

PROPERTY REVIEW

Columbia/Harlech

The Columbia/Harlech property is located in west-central Alberta within Fairborne's West Pembina core operating area, approximately 180 kilometers southwest of Edmonton. Fairborne's initial working interest position was gained through a property acquisition from BP in April 2004. The Company has been aggressively adding to its land position and increased its overall land base to 119 gross sections and 83 net sections.





The primary objectives include the Belly River, Cardium, Viking and Mannville sandstone reservoirs that, if successful, yield average reserves of 1.5 to 2.0 Bcf per completed zone and initial production rates of 1.0 to 1.5 MMcf/d. The Cardium and Viking zones are Deep Basin style Cretaceous gas accumulations that are amenable to downspacing beyond one well per section yielding longer life production capability and larger recoverable reserves. Fairborne has drilled 16 gross (10.4 net) wells in the area since commencing operations in August 2004.

Columbia/Harlech gas is processed at the West Pembina Gas Plant where Fairborne owns a 23 percent working interest. The Company also built 25.6 miles of gathering infrastructure, a compressor station capable of 15 MMcf/d and is designing the next expansion of the facilities to accommodate the 2005 drilling program.

In late 2004 Fairborne also discovered a Belly River oil pool on the downdip side of a major thrust fault structure. The first well began production in March of 2005 and the company has identified an additional 8 development locations based on 3D seismic mapping of the producing reservoir. During 2004, 1,500 sq km of 3D seismic was acquired covering the entire Columbia/Harlech-West Pembina area and this data has been instrumental in identifying structures, mapping reservoir continuity, and generating new exploration opportunities on the Company's land.

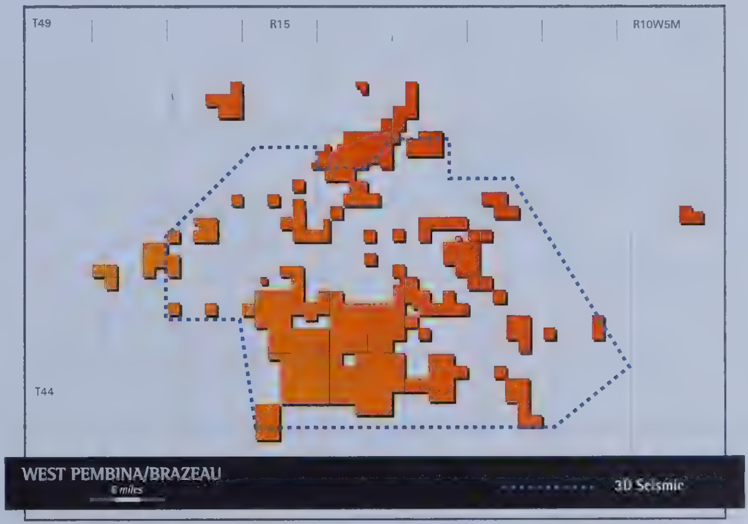
REVIEW OF OPERATIONS

Underlying the Cretaceous sandstone reservoirs at Columbia/Harlech are a number of Devonian age Nisku exploratory locations. 2005 will see at least two of these drilled during the second half of the year. These prospects are carbonate reefs that typically contain 5 Bcf to 25 Bcf of potential reserves, with initial production rates of 3 MMcf/d to10 MMcf/d.

The Company has over 45 defined drilling locations on Fairborne-controlled lands in the Columbia /Harlech area, not including potential downspacing drilling.

West Pembina

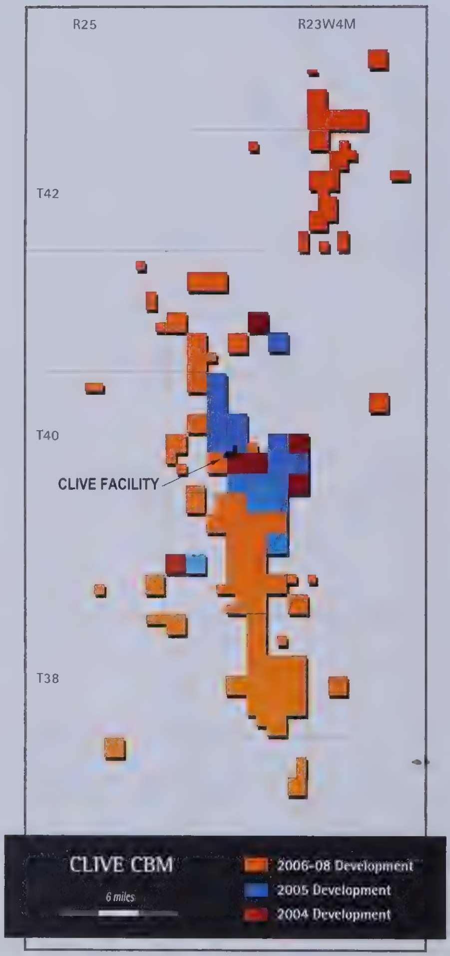
Fairborne's West Pembina property is located in west-central Alberta approximately 160 kilometers southwest of Edmonton and produces sour gas and associated natural gas liquids (NGL's) from Devonian age reservoirs in the Nisku formation. The majority of production in the Nisku comes from single well pools with initial estimated recoverable reserves ranging from 5 Bcf to 25 Bcf. Utilizing an extensive three dimensional seismic database, Fairborne drilled a successful well in the final quarter of 2004, which was brought on stream in early 2005. Also in 2004, the company performed several remedial drilling and completion operations to optimize production as well as extensive modeling of the gas gathering infrastructure to ensure increased operational efficiency.



All of the Company's sour gas in this area is processed at the West Pembina Gas Plant where the Company owns a 23 percent interest. This gas is also transported to the plant in pipelines owned by Fairborne. Ownership of these facilities should provide the Company with uninterrupted processing of the Company's gas. The successful Nisku play in the Pembina area has expanded to the northeast resulting in increased competition for processing facilities.

The Company has been active in acquiring lands in the West Pembina area in the later half of 2004 and into 2005 with successful bids at a number of Crown land sales. The Company has over 20 defined drilling locations for the Nisku on Fairborne controlled lands in the West Pembina area.

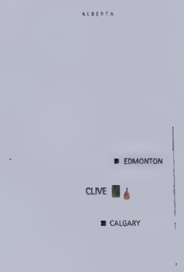
REVIEW OF OPERATIONS



Clive

The Clive core operating area, located in central Alberta approximately 50 kilometers northeast of Red Deer, was the first property purchased by Fairborne in 2002. It currently produces from two units which produce oil and gas from Devonian aged reservoirs, as well as conventional oil and natural gas from non-unitized lands in the area. In 2003 Fairborne's exploration staff began evaluating the Horseshoe Canyon Coals at Clive for the potential production of CBM. Following positive results from initial testing and production in a test group of wells in 2003, Fairborne drilled 49 wells for CBM in 2004 for a total of 51 wells that have been drilled to date. At year end 2004, 34 of these wells were producing 5.2 MMcf/d

CBM is natural gas that occurs in coal beds and has been generated during the conversion of plant material to coal. CBM from the Horseshoe Canyon coals produces water free and is composed almost entirely of methane with minor amounts (1-2 percent) of other gases, mostly nitrogen. Because coal beds serve as both the source rocks and the reservoir rocks, gas storage in coal beds is more complex than in conventional reservoirs. Completion techniques involve high pressure fracturing with nitrogen with the typical production profile illustrating flat to slightly increasing rates over the initial production period (measured in years) followed by a shallow decline. Separate production facilities also are required for CBM gas as gathering systems must operate at very low pressures. The Company has installed large diameter pipelines dedicated to the production of CBM gas as well as isolating existing compression facilities in order to keep the pressures in the gathering systems as low as possible.



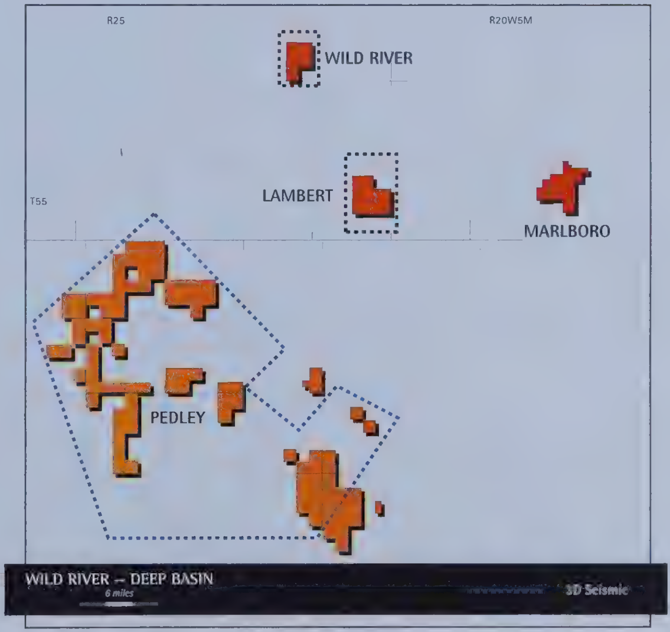
CBM gas is produced from up to 17 coal seams at Clive and the Company has gained considerable experience in the drilling and completing of these wells over the last two years. Proved Developed Producing reserves have been assigned to only 13 percent of the land at Clive and the Company plans to develop the Clive property over the next three years drilling approximately 50 wells per year.

REVIEW OF OPERATIONS

Wild River – Deep Basin

The Wild River/Deep Basin area, located approximately 250 kilometers west of Edmonton, Alberta, is a broad multi-objective natural gas fairway. It is currently one of the most active exploration and development areas in the Basin. The primary objectives in the Deep Basin are Cretaceous gas targets and deeper Devonian reefs. As of December 31, 2004 Fairborne held a working interest in 44,160 gross (21,205 net) acres of land in the Wild River/Deep Basin area, 98 percent of which is undeveloped.

In 2004 Fairborne drilled the 8-14 Wild River well (3,800 m) targeting one of these reefs and was rewarded with an exploration discovery that has produced almost 2 Bcf (1.0 Bcf net to Fairborne) since beginning production in September, 2004. Fairborne is currently participating in two of these types of wells; the Pedley 3-5 well (5,100m) which spudded on January 6, 2005 (Fairborne is paying 8.5 percent of this well and will have a 17 percent working interest in production if it is successful) and the 9-15 Wild River well (3,800m) which is located one mile west of the original 8-14 well (Fairborne will have a 41 percent interest in production if it is successful).



During 2004, 1,500 sq km of 3D seismic was acquired covering all of the Company's land base in the Deep Basin as well as the Wild River area and this data has been instrumental in identifying new structures, mapping reservoir continuity and generating new exploration opportunities on the Company's lands

The Company has assembled a number of deeper prospects on 100 percent working interest lands based on the 3D seismic data set and these will be drilled over the next two to three years. In addition to these deeper targets the Company has a number of shallower prospects targeting Cretaceous age sandstone reservoirs that will be drilled over the same time period.

REVIEW OF OPERATIONS

RESERVES

The Company's independent engineering evaluations, effective December 31, 2004, were prepared by the independent engineering firms of Gilbert Laustsen Jung Associates Ltd. ("GLJ") and, with respect to the Company's coal bed methane reserves only, Sproule Associates Ltd. ("Sproule") in accordance with the definitions set out under National Instrument 51-101 Standards of Disclosure for Oil and Gas

Gas pipeline fitting at Columbia/Harlech

Activities ("NI 51-101"). One hundred percent of the Company's reserves were evaluated by these two independent engineering firms.

The reserve highlights are;

- Gross proved reserves at December 31, 2004 increased 152 percent to 25.3 million BOE compared to 10.1 million BOE at December 31, 2003 and gross proved plus probable reserves at December 31, 2004 increased 179 percent to 38.6 million BOE compared to 13.8 million BOE at December 31, 2003.

- Proved plus probable finding, development and acquisition costs were $10.98 per BOE ($16.69 per BOE on a proved basis). Including future development costs, finding, development and acquisition costs were $12.76 per BOE and $18.42 per BOE on a proved plus probable and proved basis, respectively.

REVIEW OF OPERATIONS

FORECAST PRICES AND COSTS

Summary of Oil and Gas Reserves - *Gross[1] and Net[2] Reserves*

	Light and Medium Crude Oil		Heavy Oil		Natural Gas Liquids		Natural Gas		2004 BOE	
	Gross (Mbbl)	Net (Mbbl)	Gross (Mbbl)	Net (Mbbl)	Gross (Mbbl)	Net (Mbbl)	Gross (Bcf)	Net (Bcf)	Gross (MBOE)	Net (MBOE)
Proved reserves										
Developed producing	4,332	3,652	94	83	940	651	62.6	48.3	15,804	12,442
Developed non-producing	523	465	295	264	389	278	17.4	13.7	4,099	3,286
Undeveloped	1,089	906	44	34	291	204	24.0	18.9	5,432	4,288
Total Proved	5,944	5,022	433	381	1,621	1,133	104.0	80.9	25,335	20,016
Probable	2,308	1,978	321	282	772	540	58.9	47.4	13,223	10,697
Total Proved plus Probable	**8,252**	**7,001**	**754**	**663**	**2,393**	**1,673**	**163.0**	**128.3**	**38,558**	**30,713**

NOTE: May not add due to rounding.

(1) "Gross" reserves means the total working interest (operating and non-operating) share before deduction of royalties payable to others and without including any royalty interest of Fairborne.

(2) "Net" reserves means the total working interest (operating and non-operating) share after deduction of royalty obligations plus Fairborne's royalty interests in reserves.

Net Present Value of Reserves, before income taxes

December 31, 2004 [1],[2],[3] *($thousands)*	Undiscounted	Discounted at 5%	10%	15%	20%
Proved reserves					
Developed producing	338,573	288,974	254,584	228,968	209,003
Developed non-producing	79,359	64,682	54,463	46,991	41,314
Undeveloped	81,621	63,713	50,788	41,111	33,647
Total Proved	499,553	417,369	359,835	317,070	283,964
Probable	260,409	174,350	126,154	96,107	75,969
Total Proved plus Probable	**759,962**	**591,719**	**485,989**	**413,177**	**359,933**

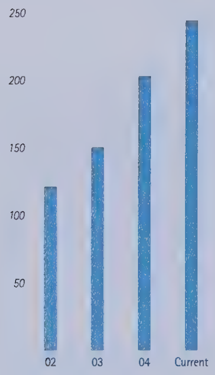
NOTE: May not add due to rounding.

(1) Utilizing GLJ January 1, 2005 price forecast

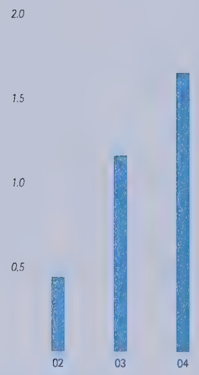
(2) As required by NI 51-101, undiscounted well abandonment costs of $10.1 million for total proved reserves and $13.6 million for total proved plus probable reserves are included in the Net Present Value determination

(3) Prior to provision of income taxes, interest, debt service charges and general and administrative expenses. It should not be assumed that the undiscounted and discounted future net revenues estimated by GLJ represent the fair market value of the reserves.

REVIEW OF OPERATIONS



PRODUCTION GROWTH PER SHARE
(BOE/day/mm share)



CASH FLOW PER SHARE
($/share)

PRICING ASSUMPTIONS

The January 1, 2005 pricing forecasts presented below have been prepared by GLJ. These prices have been utilized in determining the preceding reserves and cash flow forecasts.

	Crude Oil		Natural Gas	Inflation Rate
Year	WTI Oil ($U.S./bbl)	Edmonton Light ($Cdn/bbl)	AECO ($Cdn/MMbtu)	(%/year)
2005	42.00	50.25	6.60	2.0
2006	40.00	47.75	6.35	2.0
2007	38.00	45.50	6.15	2.0
2008	36.00	43.25	6.00	2.0
2009	34.00	40.75	6.00	2.0
2010	33.00	39.50	6.00	2.0
2011	33.00	39.50	6.00	2.0
2012	33.00	39.50	6.00	2.0
2013	33.50	40.00	6.10	2.0
2014	34.00	40.75	6.20	2.0
2015	34.50	41.25	6.30	2.0

CONSTANT PRICES AND COSTS

Net Present Value of Reserves, before income taxes

		Discounted at			
December 31, 2004 (1),(2),(3) *($thousands)*	Undiscounted	5%	10%	15%	20%
Proved reserves					
Developed producing	383,591	321,349	279,092	248,195	224,489
Developed non-producing	92,680	74,382	61,902	52,912	46,159
Undeveloped	97,315	75,737	60,339	48,913	40,165
Total Proved	573,586	471,468	401,333	350,020	310,813
Probable	305,797	203,498	146,808	111,630	88,115
Total Proved plus Probable	**879,383**	**674,966**	**548,141**	**461,650**	**398,928**

NOTE: May not add due to rounding.

(1) Price assumptions: CDN$46.54/Bbl Crude oil Edmonton light and CDN$6.79/MMbtu AECO "C".

(2) As required by NI 51-101, undiscounted well abandonment costs of $8.4 million for total proved reserves and $10.5 million for total proved plus probable reserves are included in the Net Present Value determination

(3) Prior to provision of income taxes, interest, debt service charges, and general and administrative expenses. It should not be assumed that the undiscounted and discounted future net revenues estimated by GLJ represent the fair market value of the reserves.

REVIEW OF OPERATIONS

RESERVE RECONCILIATION

Reconciliation of Company Gross Reserves [(1),(2)] by Principal Product Type

FORECAST PRICES AND COSTS

	Crude Oil & NGLs (Mbbls)		Natural Gas (Bcf)		Total (MBOE)	
	Proved	Total Proved plus Probable	Proved	Total Proved plus Probable	Proved	Total Proved plus Probable
Opening, January 1, 2004	4,798	6,003	31.7	46.9	10,073	13,811
Extensions	709	1,292	36.7	68.2	6,826	12,653
Improved recovery	35	40	–	–	35	40
Technical revisions	(139)	(255)	2.1	1.7	211	20
Discoveries	341	410	27.5	35.1	4,924	6,260
Acquisition	3,941	5,761	20.0	26.0	7,267	10,114
Disposition	(625)	(790)	(2.5)	(3.5)	(1,041)	(1,380)
Economic factors	–	–	–	–	–	–
Production	(1,062)	(1,062)	(11.4)	(11.4)	(2,960)	(2,960)
Closing, December 31, 2004	7,998	11,399	104.1	163.0	25,335	38,558

NOTE: May not add due to rounding.

(1) "Gross" reserves means the total working interest (operating and non-operating) share before deduction of royalties payable to others and without including any royalty interest of Fairborne.

(2) The Company's Net (after royalty) opening balance as of January 1, 2004 was 8,231 MBOE Proved and 1,315 MBOE Proved plus Probable

FINDING AND DEVELOPMENT COSTS (F&D) AND FINDING, DEVELOPMENT AND NET ACQUISITION COSTS (FD&A)

NI 51-101 specifies how finding and development ("F&D") costs should be calculated if they are reported. Essentially NI 51-101 requires that the exploration and development costs incurred in the year along with the change in estimated future development costs be aggregated and then divided by the applicable reserve additions. The calculation specifically excludes the effects of acquisitions and dispositions on both reserves and costs. By excluding acquisitions and dispositions Fairborne believes that the provisions of NI 51-101 do not fully reflect Fairborne's ongoing reserve replacement costs. Since acquisitions could have a significant impact on Fairborne's annual reserve replacement costs, excluding these amounts could result in an inaccurate portrayal of Fairborne's cost structure. Accordingly, Fairborne will also report finding, development and acquisition ("F,D&A") costs that will incorporate all acquisitions net of any dispositions during the year.

REVIEW OF OPERATIONS

	Proved [2]	Total Proved plus Probable [2]
2004 CAPITAL COSTS ($thousands)		
Exploration and development	135,174	135,174
Acquisitions, net of dispositions	168,988	168,988
	304,162	304,162
Change in future development costs [1]	31,498	49,488
	335,660	353,650
2004 RESERVE ADDITIONS [2] (MBOE)		
Exploration and development	11,996	18,973
Acquisitions, net of dispositions	6,226	8,734
	18,222	27,707
FINDING & DEVELOPMENT COSTS ($/BOE)		
2004 F&D costs	13.89	9.73
2004 FD&A costs	18.42	12.76
2004 F&D costs, excluding future capital	11.27	7.12
2004 FD&A costs, excluding future capital	16.69	10.98

(1) The aggregate of the exploration and development costs incurred in the most recent financial year and the change during that year in estimated future development costs generally will not reflect total finding and development costs related to reserve additions for that year.

(2) Based on Gross reserves additions meaning the total working interest (operating and non-operating) share before deduction of royalties payable to others and without including any royalty interest of Fairborne.

RESERVE LIFE INDEX

The Company's reserve life index using annualized fourth quarter production is 6.5 years (2003 - 5.8 years) for proved BOE reserves and 9.9 years (2003 - 7.9 years) for proved plus probable BOE reserves. Reserve life calculated using annualized fourth quarter production may be more reflective of reserve life due to the level of new production added during the year.

	2004		2003	
	Using Annualized Q4 Production	Using Average Production	Using Annualized Q4 Production	Using Average Production
Production (BOE per day)	10,633	8,089	4,799	3,787
Proved reserves [1] (MBOE)	25,335	25,335	10,073	10,073
Proved reserve life index (years)	6.5	8.6	5.8	7.3
Proved plus probable reserves [1] (MBOE)	38,558	38,558	13,811	13,811
Proved plus probable reserve life index (years)	9.9	13.1	7.9	10.0

(1) Based on Gross reserves meaning the total working interest (operating and non-operating) share before deduction of royalties payable to others and without including any royalty interest of Fairborne.

REVIEW OF OPERATIONS

Reserve Replacement

The Company's 2004 capital investment program replaced production by a factor of 6.2 times on a proved basis and 9.4 times on a proved plus probable basis.

	2004	2003
Production (MBOE)	2,960	1,382
Proved reserves additions [1] (MBOE)	18,222	6,075
Proved reserve replacement ratio	6.2	4.4
Proved plus probable reserves additions [1] (MBOE)	27,708	8,972
Proved plus probable reserve replacement ratio	9.4	6.5

(1) Based on Gross reserves meaning the total working interest (operating and non-operating) share before deduction of royalties payable to others and without including any royalty interest of Fairborne.

Recycle Ratio

The recycle ratio is a measure for evaluating the effectiveness of a company's re-investment program. It accomplishes this by comparing the operating netback per barrel of oil equivalent to that year's reserve finding and development costs.

	2004	2003
Operating netback ($/BOE)	25.51	23.93
Proved FD&A costs, including future development ($/BOE)	18.42	14.46
Proved recycle ratio	1.4	1.7
Proved plus probable FD&A costs, including future development ($/BOE)	12.76	9.90
Proved plus probable recycle ratio	2.0	2.4

THE RIGHT | RESULTS

Since inception in 2002, Fairborne's balanced acquisition, exploration and development strategy has resulted in impressive growth in production, revenue, funds generated from operations and net income.

M D & A

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") was prepared at, and is dated, March 8, 2005. This MD&A is provided by the management of Fairborne Energy Ltd. ("Fairborne" or the "Company") to review 2004 activities and results as compared to the previous year, and should be read in conjunction with the audited consolidated financial statements including notes for the years ended December 31, 2004 and 2003. Additional information relating to Fairborne, including Fairborne's annual information form, is available on SEDAR at www.sedar.com.

Fairborne was incorporated as a private company and commenced active operations in June, 2002. In 2003, Fairborne became a publicly traded company. The Company maintains its head office in Calgary and is engaged in the business of exploring for, developing, acquiring and producing crude oil and natural gas in Western Canada. Fairborne follows a strategy of balancing risk and reward by focusing on opportunities within geographic area and prospect type. Within these selected areas, the Company develops a portfolio of exploration and development prospects in conjunction with an active acquisition strategy.

MD&A

Forward Looking Statements: *This MD&A contains forward-looking statements. Forward-looking statements are based on current expectations that involve a number of risks and uncertainties which could cause events or results to differ materially from those reflected in the MD&A. Forward-looking statements are based on the estimates and opinions of Fairborne's management at the time the statements were made. Fairborne assumes no obligation to update forward-looking statements should circumstances or management's estimates change.*

Non-GAAP Terms: *This document contains the terms "funds generated from operations" and "netbacks" which are non-GAAP terms. The Company uses these measures to help evaluate its performance. The Company considers corporate netbacks a key measure as it demonstrates its profitability relative to current commodity prices. The Company considers funds generated from operations a key measure as it demonstrates the Company's ability to generate funds necessary to repay debt and to fund future growth through capital investment. Funds generated from operations should not be considered as an alternative to, or more meaningful than, cash flow from operating activities as determined in accordance with Canadian GAAP as an indicator of Fairborne's performance. Fairborne's determination of funds generated from operations may not be comparable to that reported by other companies. The reconciliation between net income and funds generated from operations can be found in the statement of cash flows in the financial statements. Fairborne also presents funds generated from operations per share whereby per share amounts are calculated using weighted average shares outstanding consistent with the calculation of income per share.*

BOE Conversions: *Barrel of oil equivalent ("BOE") amounts may be misleading, particularly if used in isolation. A BOE conversion ratio has been calculated using a conversion rate of six thousand cubic feet of natural gas to one barrel and is based on an energy equivalent conversion method application at the burner tip and does not necessarily represent an economic value equivalent at the wellhead.*

M D & A

HIGHLIGHTS

- Production more than doubled in 2004 to an average of 8,089 BOE per day from 3,787 BOE per day in 2003.
- A successful drilling program including 109 wells contributed to gains in production and reserves.
- Select property and corporate acquisitions strengthened the Company's position in its core areas of operations bringing increased production, funds generated from operations and an expanded inventory of exploration and development opportunities.
- Acquisition of properties in West Pembina effective March 31, 2004 strengthened Fairborne's position as a natural gas producer.
- Corporate acquisition of Case Resources Inc. ("Case"), financed through a share exchange, added properties contiguous to the Company's existing core areas in central Alberta.
- Equity financings during 2004 raised a total of $97.1 million, including $24.7 million from the issue of flow-through shares.
- Funds generated from operations per share increased 42 percent from $1.16 per share in 2003 to $1.65 per share in 2004.
- Share price closed at $12.05 on December 31, 2004 (2003 - $5.50), trading as high as $13.20 (2003 - $6.07) during the year.

Financial Highlights *($ thousands, except per share amounts)*

	2004	2003*	% change
Petroleum and natural gas sales, before royalties	125,604	51,159	146%
Funds generated from operations	66,399	29,151	128%
Per share - basic	$ 1.65	$ 1.16	42%
Per share - diluted	$ 1.54	$ 1.10	40%
Net income	13,702	10,322	33%
Per share - basic	$ 0.34	$ 0.41	(17%)
Per share - diluted	$ 0.32	$ 0.39	(18%)
Exploration and development expenditures	135,174	34,496	292%
Acquisitions, net of dispositions	168,988	45,883	268%
Working capital deficit, including bank debt	98,058	9,371	946%

* *Restated due to change in accounting policy with respect to Asset Retirement Obligations*

M D & A

Operations Highlights *(Units as noted)*

	2004	2003*	% change
Average production			
Natural gas (Mcf per day)	31,116	10,640	192%
Crude oil (Bbls per day)	2,593	1,850	40%
Natural gas liquids (Bbls per day)	309	164	88%
Total (BOE per day)	8,089	3,787	114%
Average sales price			
Natural gas ($ per Mcf)	6.68	6.24	7%
Crude oil ($ per Bbl)	46.40	35.70	30%
Natural gas liquids ($ per Bbl)	44.23	35.00	26%
Total ($ per BOE)	42.26	36.54	16%
Netback ($ per BOE)			
Petroleum and natural gas sales	42.42	37.01	15%
Royalties	8.96	6.83	31%
Operating expenses	7.95	6.25	27%
Operating netback	25.51	23.93	7%

* *Restated due to change in accounting policy with respect to Asset Retirement Obligations*

SELECTED ANNUAL INFORMATION

($ thousands, except per share amounts)	2004	2003*	7 Months ended December 31, 2002*
Petroleum and natural gas sales, before royalties	125,604	51,159	16,376
Funds generated from operations	66,399	29,151	8,774
Per share – basic	$ 1.65	$ 1.16	$0.44
Per share – diluted	$ 1.54	$ 1.10	$0.44
Net income	13,702	10,322	2,508
Per share – basic	$ 0.34	$ 0.41	$0.13
Per share – diluted	$ 0.32	$ 0.39	$0.13
Total assets	434,830	139,925	51,544
Working capital deficit, including bank debt	98,058	9,371	(2,130)
Long term financial liabilities			
Equipment leases	–	–	2,573
Asset retirement obligations	13,196	6,165	4,135
Future income taxes	35,860	15,913	1,022
Shareholders' Equity	247,777	86,201	36,945

* *Restated due to change in accounting policy with respect to Asset Retirement Obligations*

M D & A

Fairborne was incorporated as a private company and commenced active operations in June, 2002. In 2003, Fairborne became a publicly traded company and completed a merger with Pivotal Energy Ltd. ("Pivotal"), increasing production by over 50 per cent. Fairborne also spent $34.5 million in 2003 on exploration and development activities which included drilling 30 wells. In 2004, Fairborne drilled 109 wells as part of an extensive exploration and development program which resulted in average production doubling from the previous year. Also in 2004, Fairborne successfully completed a significant property acquisition in West Pembina and a corporate acquisition of Case. The Company has financed its acquisition, exploration and development activities through a combination of funds generated from operations, bank debt and common share equity financings which included the issue of flow-through shares. The net result of Fairborne's balanced acquisition, exploration and development strategy has been two consecutive years of growth in production, revenue, funds generated from operations and net income.

QUARTERLY FINANCIAL INFORMATION

The following is a summary of selected financial information for the quarterly periods indicated:

2004

	Q4	Q3	Q2	Q1
Financial *($ thousands, except per share amounts)*				
Petroleum and natural gas sales, before royalties	41,976	35,391	29,787	18,450
Funds generated from operations	21,569	19,784	15,083	9,963
Per share - basic	$ 0.47	$ 0.48	$ 0.39	$ 0.31
Per share - diluted	$ 0.46	$ 0.44	$ 0.36	$ 0.28
Net income	4,158	3,463	2,786	3,295
Per share - basic	$ 0.09	$ 0.08	$ 0.07	$ 0.10
Per share - diluted	$ 0.08	$ 0.08	$ 0.07	$ 0.09
Total assets	434,830	379,450	272,115	266,338
Working capital deficit, including bank debt	98,058	95,091	84,785	90,870
Operations				
Average production				
Natural gas (Mcf per day)	43,480	32,569	30,410	17,853
Crude oil (Bbls per day)	2,892	3,038	2,492	1,956
Natural gas liquids (Bbls per day)	495	348	241	139
Total (BOE per day)	10,633	8,814	7,801	5,071

M D & A

2003 *(restated)*

	Q4	Q3	Q2	Q1
Financial *($ thousands, except per share amounts)*				
Petroleum and natural gas sales, before royalties	15,523	15,779	10,254	9,603
Funds generated from operations	8,409	9,056	5,985	5,701
Per share - basic	$ 0.27	$ 0.30	$ 0.30	$ 0.29
Per share - diluted	$ 0.23	$ 0.28	$ 0.30	$ 0.29
Net income	2,308	3,069	2,723	2,222
Per share - basic	$ 0.06	$ 0.10	$ 0.14	$ 0.11
Per share - diluted	$ 0.06	$ 0.09	$ 0.13	$ 0.11
Total assets	139,925	121,124	60,629	55,769
Working capital deficit, including bank debt	9,371	17,463	Nil	Nil
Operations				
Average production				
Natural gas (Mcf per day)	14,835	14,265	7,283	5,596
Crude oil (Bbls per day)	2,144	2,291	1,542	1,497
Natural gas liquids (Bbls per day)	182	147	167	162
Total (BOE per day)	4,799	4,815	2,922	2,592

FOURTH QUARTER 2004 RESULTS

Having assimilated the West Pembina property acquisition from the first quarter and the corporate acquisition of Case in the third quarter, Fairborne was able to focus on exploration, development and operating activities in the fourth quarter of 2004. During the fourth quarter the Company spent $59.1 million on exploration and development projects which included drilling 31 (26.1 net) wells. The capital program was financed through a combination of funds generated from operations, drawings on credit facilities and proceeds from equity issues.

Operationally, the Company brought on new production from both the Columbia/Harlech property and the coal bed methane development at Clive. With these new properties on-stream, Fairborne increased its average production to 10,633 BOE per day in the fourth quarter from 8,814 BOE per day in the third quarter of 2004. Consistent with increased production, Fairborne recorded gains in total revenue (Q4 2004 - $42 million), funds generated from operations (Q4 2004 - $21.6 million) and net income (Q4 2004 - $4.2 million) in the fourth quarter of 2004 as compared to the immediately preceding third quarter and also compared to the fourth quarter of 2003.

In December 2004, the Company completed an equity financing including 2.7 million common shares issued at $11.50 per share and 322,000 flow-through shares issued at $14.50 per share for gross proceeds of $36.0 million. As a result of the flow-through component of the December 2004

financing, the Company has a commitment to spend $4.7 million on qualifying Canadian exploration expenditures prior to December 31, 2005; all of which have been renounced to subscribers effective December 31, 2004.

Also in December 2004, the Company increased its available credit facility to $125.0 million from $105 million at the end of the third quarter 2004. After applying the proceeds of the equity financing, the Company reduced its bank debt to $77.2 million at December 31, 2004 leaving $47.8 million of available borrowing capacity.

2004 FINANCIAL RESULTS

Production and Prices

(units as noted)	2004	2003	% change
Production			
Natural gas (Mcf per day)	31,116	10,640	192%
Oil and NGLs (Bbls per day)	2,902	2,014	44%
Total (BOE per day)	8,089	3,787	114%
Prices			
Natural gas ($ per Mcf)	6.68	6.24	7%
Oil and NGLs ($ per Bbl)	46.17	35.86	29%
Total ($ per BOE)	42.26	36.54	16%

Production

Fairborne's average 2004 production of 8,089 BOE per day more than doubled 2003 production of 3,787 BOE per day. Select acquisitions and a focused drilling program strengthened the Company's position as a natural gas producer with natural gas representing 64 percent of the Company's 2004 production compared to 47 percent in 2003.

Natural gas production averaged 31.1 MMcf per day in 2004, almost three times the 2003 average of 10.6 MMcf per day. Increases in natural gas production were a direct result of successful exploration and development drilling on the Company's Rycroft, Basset Lake and Wild River areas as well as the acquisition of West Pembina properties. Production from West Pembina is included in the Company's results beginning April 1, 2004. Production from Rycroft and Wild River occurred late in the third quarter of 2004 with the start-up of an expanded Rycroft gas processing facility and completion of a new pipeline at Wild River. In the fourth quarter the Company brought on new production from its Columbia/Harlech property as well as coal bed methane wells in the Clive area. Natural gas production in 2005 is expected to increase further with a full year of production from all areas added in 2004 as well as new 2005 drilling including an extensive coal bed methane development program.

M D & A

Crude oil and NGL production for 2004 averaged 2,902 Bbls per day, representing a 44 per cent increase from the 2003 average of 2,014 Bbls per day. The increase in oil production is primarily attributable to the acquisition of Case on July 27, 2004 with some incremental oil production from West Pembina. Case's production was heavily weighted towards oil, with the majority of production coming from the Haynes property, located adjacent to the Company's Clive and Wood River properties in central Alberta. With the Company's increased emphasis on natural gas, crude oil production is expected to remain flat, but concurrent with increased natural gas production, the Company expects to further increase NGL production in 2005 with full year production from properties added in 2004 and new 2005 drilling prospects.

Fairborne expects to record higher average production levels in 2005 compared to 2004. However, Fairborne's production will be affected by scheduled maintenance projects at two facilities which will result in production being reduced by approximately 4,500 BOE per day for 18-21 days in May 2005.

Commodity Prices & Hedging Activities

Fairborne recorded a crude oil and NGL price of CDN$46.17 per Bbl in 2004 (2003 - CDN$35.86), which reflected strengthened world oil prices. Fairborne realized a natural gas price of $6.68 per Mcf in 2004 compared to $6.24 per Mcf in 2003.

Fairborne's realized prices reflect the impact of fixed price contracts utilized by the Company as part of its hedging program. When Fairborne hedges oil and gas prices, the intention is to provide certainty to cash flow by fixing the price on a portion of the production portfolio. During 2004, Fairborne hedged an average of 388 barrels per day (13 percent) of crude oil production, which reduced the crude oil price received by $2.52 per Bbl. Natural gas hedges in 2004 applied to an average of 1.1 MMcf per day (3.5 percent) of natural gas production, which increased the natural gas price received by $0.01 per Mcf. Comparably, the Company did not hedge any of its production in 2003.

Commodity prices for both crude oil and natural gas were generally strong throughout 2004 and the outlook for future prices remains high. Two fixed price sales contracts are in place for 2005 including a crude oil contract for 1,000 Bbls per day from January 1, 2005 to March 31, 2005 at a price of WTI US$34.70. A natural gas contract for 10,000 GJ per day is also outstanding from February 1, 2005 to March 31, 2005 with a floor price of AECO CDN$6.50 and a settlement price of CDN$6.50 plus 50 percent of the AECO C Monthly Index over $6.50.

In addition to fixed price commodity contracts, Fairborne also had a foreign exchange hedge in place from January 27, 2004 to June 30, 2004 on US$1.6 million at a rate of Cdn $1.323 to U.S. $1.00 (U.S. $0.7559 to Cdn $1.00). From July 1 to September 30, 2004, the Company hedged U.S. $1.0 million of foreign exchange exposure at a rate of Cdn $1.3468 to U.S. $1.00 (U.S. $0.7425 to Cdn $1.00). The Company recognized a nominal gain from the exchange hedges, with no additional exchange hedges outstanding for 2005.

Petroleum and Natural Gas Revenue

	2004	2003	% change
Revenue *($ thousands)*			
Natural gas	76,073	26,363	189%
Oil and NGLs	49,048	24,413	101%
Other income	483	383	26%
Total	125,604	51,159	146%
Revenue per BOE	$ 42.42	$ 37.01	15%

Increases in production levels and commodity prices resulted in a substantial increase in revenues from both crude oil and natural gas. Total revenues of $125.6 million in 2004 were 146 percent higher than the 2003 level of $51.1 million, primarily as a result of increased production.

Royalties

(units as noted)	2004	2003	% change
Royalties *($ thousands)*			
Crown	20,567	6,235	230%
Freehold and overriding	5,959	3,201	86%
Total	26,526	9,436	181%
Royalty Rates			
Crown	16.4%	12.2%	34.4%
Freehold and overriding	4.7%	6.3%	(25.4%)
Total	21.1%	18.4%	14.7%
Royalties per BOE	$ 8.96	$ 6.83	31.2%

The Company recorded $26.5 million in royalties in 2004 (2003 - $9.4 million), representing a royalty rate of 21.1 percent (2003 - 18.4 percent). Fairborne's average royalty rate began to increase in the latter part of 2003 with further increases throughout 2004 as a result of new property acquisitions. Each of the new properties acquired by Fairborne including Pivotal (July 2003), West Pembina (March 2004) and Case (July 2004), have royalty rates in excess of the rates associated with Fairborne's initial properties which formed the Company's revenue base until July 2003.

Fairborne's 2004 Crown royalty rate also reflects a deep well royalty holiday on the Company's new gas well at Wild River, which is expected to continue through the first quarter of 2005. Based on the Company's current production profile, the combined effective royalty rate for 2005 is expected to increase slightly from 2004 to average between 21 percent and 23 percent.

Production Expenses

	2004	2003	% change
Operating expenses *($ thousands)*			
Natural gas	16,485	4,116	301%
Crude oil and NGLs	7,071	4,520	56%
Total	23,556	8,636	173%
Operating expenses per BOE	$ 7.95	$ 6.25	27%

The addition of new properties at West Pembina, Basset Lake and Wild River along with general increases in industry service related charges have contributed to an increase in unit operating costs from $6.25 per BOE in 2003 to $7.95 per BOE in 2004. Operating costs in West Pembina at the time of acquisition were significantly higher than the Company's core producing properties due primarily to the sour nature of the production. Basset Lake, which commenced production in 2004, is a winter-access only area and the remote nature of the operations results in higher transportation and field operating costs. At Wild River, the existence of elemental sulphur deposits require on-going maintenance resulting in scheduled downtime and high maintenance costs.

As operator, Fairborne continually evaluates the operating netbacks on its core properties and works to achieve operating efficiencies to reduce operating costs. Since taking over as operator of the West Pembina properties in May 2004, the Company has been working to optimize field operations and reduce operating costs by increasing facility on-line time, optimizing liquids handling and increasing overall plant throughput with the addition of the Columbia/Harlech production. At Basset Lake, the Company is converting the operation from a fly-in facility to camp based operations. At Wild River, the installation of a down-hole injection string scheduled for May 2005, along with additional surface facilities will be a more cost effective treatment for the sulphur deposition issue resulting in substantially less downtime. By making these operational improvements, Fairborne expects to reduce operating costs in 2005 to average between $7.00 and $7.50 per BOE.

Operating Netbacks

($ per BOE)	2004	2003	% change
Revenue	42.42	37.01	15%
Royalties	8.96	6.83	31%
Operating costs	7.95	6.25	27%
Operating netback	25.51	23.93	7%

Despite increased unit operating costs and higher royalty rates, stronger commodity prices resulted in an increase in Fairborne's operating netback of $25.51 per BOE in 2004 compared to $23.93 per BOE in 2003.

General and Administrative Expenses

The substantial growth in Fairborne's production and asset base combined with the active acquisition, exploration and development programs undertaken by the Company have led to an increased need for staff, office space and support services. General and administrative expenses (excluding non-cash compensation expense) of $5.9 million in 2004 (2003 - $3.2 million) reflects the Company's growth. On a BOE basis, Fairborne's general and administrative costs have been reduced from $2.32 per BOE in 2003 to $2.01 per BOE in 2004. Also included in general and administrative costs is $873,000 (2003 - $154,000) in non-cash stock based compensation expense recorded with the issue of stock options during the year. Fairborne expects to see a further increase in total general and administrative expenses in 2005 with continued growth in operations and an extensive capital expenditure program. However, with anticipated increases in production levels, on a BOE basis, general and administrative expenses for 2005 should decrease.

Interest Expense

Prior to the acquisition of Pivotal in July 2003, Fairborne did not have bank debt. The Pivotal acquisition and subsequent corporate and property acquisitions have been financed through a combination of debt and equity. As such, interest expense increased in 2004 to $2.5 million from $0.5 million in 2003. At December 31, 2004, the Company had $125 million of available operating credit facilities and had drawn $77.2 million under the facilities. The Company will continue to use a combination of funds generated from operations, bank debt and equity financing to fund its 2005 capital program as well as to pursue future acquisition opportunities.

Depletion, Depreciation and Accretion

Fairborne recorded $41.9 million of depletion and depreciation expense in 2004 (2003 - $12.8 million), representing a rate of $14.16 per BOE (2003 - $8.99 per BOE). The increase in depletion expense from 2003 is a result of increased production levels and increased depletion rates. The increase in BOE rates during 2004 is primarily attributable to the acquisition of West Pembina properties and the acquisition of Case.

Acquisitions completed in 2004 also resulted in an increased liability for asset retirement costs and associated accretion expense. The Company estimates its total undiscounted future liability for asset retirement obligations to be $44.0 million, the present value of which is $13.2 million at December 31, 2004. Accretion of asset retirement obligations in 2004 was $918,000 (2003 - $558,000).

Taxes

Fairborne's effective tax rate for 2004 was 41.3 percent (2003 - 34.9 percent), the majority of which is recorded as future income taxes. Based on expected capital expenditures and revenues for 2005, the Company does not anticipate paying cash income taxes other than capital taxes in 2005.

Funds Generated from Operations and Net Income

($ thousands except per share amounts)	2004	2003	% change
Funds generated from operations	66,399	29,151	128%
Per share - basic	$ 1.65	$ 1.16	42%
Per share - diluted	$ 1.54	$ 1.10	40%
Net income	13,702	10,322	33%
Per share - basic	$ 0.34	$ 0.41	(17%)
Per share - diluted	$ 0.32	$ 0.39	(18%)

Strong commodity prices and increased production levels contributed to the increase in funds generated from operations to $66.4 million ($1.65 per share) in 2004. Higher depletion, depreciation and future income tax charges impacted net income at $13.7 million ($0.34 per share) for the year.

Unit Analysis

Year ended December 31 ($ thousands except per unit amounts)	2004	$/BOE	2003 (restated)	$/BOE (restated)
Production revenue	125,604	42.42	51,159	37.01
Royalties	26,526	8.96	9,436	6.83
Operating expenses	23,556	7.95	8,636	6.25
General & administrative *	5,946	2.01	3,215	2.32
Interest	2,532	0.86	517	0.37
Capital taxes	645	0.22	204	0.15
Funds generated from operations	66,399	22.42	29,151	21.09
Compensation expense	873	0.29	154	0.11
Depletion, depreciation and accretion	42,846	14.47	13,340	9.65
Future income taxes	8,978	3.03	5,335	3.86
Net Income	13,702	4.63	10,322	7.47

* *net of compensation expense (non-cash)*

LIQUIDITY AND CAPITAL RESOURCES

Capital Expenditures

Fairborne's exploration and development program for 2004 totaled $135.2 million primarily focused on drilling and completion activities. Acquisitions in 2004 included $111.5 million for the West Pembina property in the first quarter and $68.1 million for the third quarter acquisition of Case. Disposition of several minor properties was completed in the second quarter for proceeds of $10.7 million. The following table provides a summary of expenditures compared to the previous year:

($ thousands)	2004	2003
Exploration and development		
Land and lease acquisitions	6,873	4,297
Geological and geophysical	7,741	1,704
Drilling, completions and workovers	79,731	19,371
Well equipment and facilities	40,394	8,843
Corporate assets	435	281
	135,174	34,496
Acquisitions, net of dispositions		
Acquisitions		
Property	111,535	–
Corporate	68,121	47,426
Dispositions	(10,668)	(1,543)
	168,988	45,883
Total	304,162	80,379

Expenditures for land and leases during 2004 combined with the acquisition of Case resulted in Fairborne holding 230,422 net acres of undeveloped land at December 31, 2004 with an average working interest of 66 percent.

Fairborne's exploration and development program included a very successful drilling program in 2004. The Company drilled a total of 109 (85.2 net) wells resulting in 100 (77.2 net) natural gas wells, 3 (3.0 net) oil wells and 6.0 (5.0 net) dry holes for an overall net success rate of 94 percent. Facility projects included construction of a ten mile, six inch pipeline and associated dehydration facilities at Wild River as well as completion of a new gas processing facility at Rycroft.

Exploration and development expenditures were financed through a combination of funds generated from operations ($66.4 million), bank debt and equity financings. Acquisitions were also financed through a combination of debt and equity.

The Company's capital program for 2005 has been budgeted at $150 million and includes the drilling of 130 wells. This capital program is expected to be funded by funds generated from operations and additional available bank debt.

Working Capital Deficit

Fairborne had a total working capital deficit of $98.1 million (2003 - $9.4 million) at December 31, 2004 which included bank debt of $77.2 million (2003 - $7.9 million). Bank debt is included in current liabilities due to the demand nature of the facility. The Company has selected a demand credit facility as it offers increased flexibility and reduced carrying costs compared to many long-term debt arrangements. Based on the Company's current property base, planned exploration and development activities and expected future cash flows, the Company does not expect to have any requirement to repay the facility within the next year.

Excluding bank debt and equipment leases, Fairborne had a working capital deficiency of $20.9 million at December 31, 2004 compared to $1.4 million at December 31, 2003. The increase is consistent with the substantial increase in spending on exploration and development projects in 2004 as well as the significant growth in the Company's operations over the past year.

Bank Indebtedness

Fairborne has a revolving demand loan based on a borrowing base determined by the Company's bankers. During 2004, the amount available under the loan was increased first to $85 million at the end of the first quarter in connection with the acquisition of West Pembina properties, then to $105 million in the third quarter coincident with the Case acquisition and subsequently to $125 million in December 2004. At December 31, 2004, the Company had drawn $77.2 million on the facility, leaving $47.8 million of available borrowing capacity.

Share Capital

During 2004, Fairborne issued a total of 16.9 million common shares, of which 6.2 million were issued in connection with the West Pembina acquisition; 5.4 million were issued on the acquisition of Case; 1.9 million were issued under flow-through financing; 2.7 million were issued as common equity financing; and 0.7 million were issued on exercise of stock options. In connection with these offerings, the Company received $98.8 million of new equity financing in addition to deemed proceeds of $51.5 million for shares issued to former Case shareholders.

Common shares issued during 2004 included shares issued to officers and directors of the Company as follows: 58,950 flow-through shares issued for cash; 20,000 common shares issued for cash; and 483,000 common shares issued on the exercise of stock options.

The Company is authorized to issue an unlimited number of common shares and an unlimited number of preferred shares. The following table provides a summary of outstanding common shares and other equity instruments as at the dates indicated:

	March 8	December 31	
(thousands)	2005	2004	2003
Common shares	49,204	49,202	32,328
Warrants	1,960	1,960	1,960
Stock options	3,630	3,624	2,861
Weighted average common shares			
Basic	n/a	40,293	25,178
Diluted	n/a	43,213	26,424

CONTRACTUAL OBLIGATIONS & COMMITMENTS

Fairborne has certain lease commitments for its office premises through to September 30, 2008. As at December 31, 2004, the annual payment due under these leases is approximately $460,000 for each of the next four years.

Fairborne has a commitment to spend $7.4 million on qualifying Canadian exploration expenditures prior to December 31, 2005 pursuant to flow-through share issues in August 2004 and December 2004.

OFF-BALANCE-SHEET ARRANGEMENTS

Fairborne has no off-balance-sheet arrangements.

SUBSEQUENT EVENT

On March 8, 2005 the Company's Board of Directors unanimously approved a proposal to create Fairborne Energy Trust (the "Trust"), a new oil and gas trust and a public exploration-focused junior producer, Fairquest Energy Limited ("Fairquest") pursuant to a Plan of Arrangement (the "Arrangement"). Upon completion of the Arrangement, shareholders of Fairborne will receive one trust unit of Fairborne Energy Trust (or exchangeable share subject to a maximum number of exchangeable shares being issued) and one third of a share in Fairquest for each Fairborne share held. An information circular detailing the Arrangement is anticipated to be mailed to security holders in April 2005. A meeting of security holders to consider the reorganization is expected to occur in late May 2005. The Plan of Arrangement will require the approval of 66 2/3 percent of the votes cast by the shareholders and optionholders of Fairborne voting at the security holder meeting as a single class and the approval of the majority of the shareholders excluding certain related parties. In addition, the approval of the Court of Queen's Bench and certain regulatory agencies will also be required.

M D & A

BUSINESS ENVIRONMENT AND RISK

The business risks the Company is exposed to are those inherent in the oil and gas industry as well as those governed by the individual nature of Fairborne's operations. Geological and engineering risks, the uncertainty of discovering commercial quantities of new reserves, commodity prices, interest rate and foreign exchange risks, competition and government regulations - all of these govern the businesses and influence the controls and management at the Company. Fairborne manages these risks by:

- attracting and retaining a team of highly qualified and motivated professionals who have a vested interest in the success of the Company;
- operating properties in order to identify and capitalize on opportunities;
- employing risk management instruments to minimize exposure to fluctuations in commodity prices, interest rates and foreign exchange rates;
- maintaining a strong financial position; and
- maintaining strict environmental, safety and health practices.

CRITICAL ACCOUNTING ESTIMATES

Depletion and depreciation expense

The Company uses the full cost method of accounting for exploration and development activities whereby all costs associated with these activities are capitalized, whether successful or not. The aggregate of capitalized costs, including future development costs, net of certain costs related to unproved properties is subject to amortization as depletion and depreciation expense. Depletion and depreciation expense is calculated on a unit-of-production based on estimated proved reserves.

The costs of acquiring and evaluating unproved properties are initially excluded from depletion calculations. These properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of impairment is added to the costs subject to depletion.

Full cost accounting ceiling test

The carrying value of petroleum and natural gas properties and equipment is reviewed at least annually for impairment. Any impairment would be included as additional depletion and depreciation in the period which it occurred. The carrying value is based on estimates of proved reserves, production rates, commodity prices, future capital costs, royalty rates and other assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

Asset Retirement Obligation ("ARO")

The Company estimates the fair value of ARO in the period in which it is incurred and records an ARO liability with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted on the unit-of-production method based on estimated proved reserves. The liability amount is increased each reporting period due to the passage of time based on an estimated risk-free interest rate, and the amount of accretion is expensed to income in the period.

Income Taxes

The Company follows the liability method of accounting for income taxes. The determination of the Company's income and other tax liabilities requires interpretation of laws and regulations, which are revised periodically. All tax filings are subject to audit and could be reassessed after a considerable period of time. Future tax assets and liabilities are booked at substantively enacted future income tax rates which include changes over a period of time. The rate used by the Company is based on estimated future net revenues, estimated future depletion rates and other assumptions. Accordingly, the actual income tax liability may differ significantly from the amounts estimated and can impact the current and future income tax expense recorded in future periods.

CHANGES IN ACCOUNTING POLICIES

During 2004, Fairborne implemented changes in accounting policies as required by Canadian generally accepted accounting principles.

Full cost accounting guideline

Effective January 1, 2004, Fairborne adopted a new accounting standard relating to full cost accounting for oil and gas entities. Fairborne places a limit on the carrying value of petroleum and natural gas properties and equipment, which may be depleted against revenues of future periods (the "ceiling test"). The carrying value is assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves, the lower of cost and market of unproved properties and the cost of major development projects exceeds the carrying value. When the carrying value is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value of assets exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves, the lower of cost and market of unproved properties and the cost of major development projects. The cash flows are estimated using expected future product prices and costs and are discounted using a risk-free interest rate.

Prior to adopting the new standards, the limit on aggregate carrying value of the petroleum and natural gas properties and equipment that may be carried forward for depletion against future revenues was based on the sum of the undiscounted cash flows expected from the production of proved reserves, the lower of cost or market of unproved properties and the cost of major development projects less the estimated future costs for administration, financing, asset retirement obligations and income taxes.

There were no changes to net income, petroleum and natural gas properties and equipment or any other reported amounts in the financial statements as a result of adopting the standard.

Asset retirement obligations ("ARO")

Effective January 1, 2004, Fairborne retroactively adopted, with restatement of prior periods, a new accounting standard relating to asset retirement obligations.

Fairborne recognizes the fair value of ARO in the period in which it is incurred when a reasonable estimate of the fair value can be made. The fair value of the estimated ARO is recorded as a liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted on the unit-of-production method based on proved reserves. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is expensed to income in the period. Actual costs incurred upon the settlement of the ARO are charged against the ARO.

Prior to adopting the standard, Fairborne recognized a provision for future site restoration costs over the life of the oil and gas properties and facilities using a unit of production method.

The effect of adopting the new ARO accounting standard is presented below as increases (decreases):

As at December 31,	2003	2002
Balance sheet		
Net asset retirement costs, included in fixed assets	3,740	3,158
Asset retirement obligations	6,165	4,135
Accumulated provision for future site restoration	(2,764)	(1,086)
Future income taxes	122	40
Retained earnings	217	69

Year ended December 31,	2004	2003
Statement of operations		
Accretion expense	918	558
Depletion and depreciation on asset retirement costs	1,083	619
Future site restoration expense	(3,835)	(1,405)
Future income taxes	660	82
Net income impact	1,174	146
Per share impact		
Basic	$ 0.03	$ 0.01
Diluted	$ 0.03	$ 0.01

Flow-through shares

Effective January 1, 2004, Fairborne prospectively adopted a new accounting standard for flow-through shares. Under this standard, the resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. A future tax liability is recognized upon the renunciation of tax pools and share capital is reduced by a corresponding amount.

Prior to adopting this standard, the future tax liability and share capital were adjusted when the shares were issued. There were no changes to net income, petroleum and natural gas properties and equipment or any other reported amounts in the financial statements as a result of adopting the standard.

MANAGEMENT'S REPORT

TO THE SHAREHOLDERS OF FAIRBORNE ENERGY LTD.

The accompanying consolidated financial statements of Fairborne Energy Ltd. and all the information in this Annual Report are the responsibility of management and have been approved by the Board of Directors.

The consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the consolidated financial statements are presented fairly, in all material respects. The financial information contained elsewhere in this report has been reviewed to ensure consistency with the consolidated financial statements.

Management has established systems of internal controls, which are designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and to produce reliable accounting records for the preparation of financial information.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal controls. It exercises its responsibilities primarily through the Audit Committee, which is comprised of independent, non-management directors. The Audit Committee has reviewed the consolidated financial statements with management and the auditors and has reported to the Board of Directors which have approved the consolidated financial statements.

The consolidated financial statements have been audited by KPMG LLP, the external auditors, in accordance with auditing standards generally accepted in Canada on behalf of the shareholders.

R. A. Walls

Richard A. Walls
President and Chief Executive Officer

R. A. Maitland

Robert A. Maitland, CA
Vice-President, Finance and Chief Financial Officer

Calgary, Canada
March 8, 2005

AUDITORS' REPORT

TO THE SHAREHOLDERS OF FAIRBORNE ENERGY LTD.

We have audited the consolidated balance sheets of Fairborne Energy Ltd. as at December 31, 2004 and 2003 and the consolidated statements of operations and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2004 and 2003 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Calgary, Canada
March 8, 2005

CONSOLIDATED BALANCE SHEETS

As at December 31,

($thousands)		2004	2003
			(restated, see Note 2)
ASSETS			
Current assets			
Cash and cash equivalents		$ 241	$ 6,152
Accounts receivable		36,608	14,126
Prepaid expenses and deposits		3,090	1,997
		39,939	22,275
Capital assets	(Note 4)	378,721	111,290
Goodwill	(Note 3)	16,170	6,360
		$ 434,830	$ 139,925
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities		$ 60,778	$ 21,132
Equipment lease	(Note 5)	–	2,573
Bank indebtedness	(Note 6)	77,219	7,941
		137,997	31,646
Asset retirement obligation	(Note 7)	13,196	6,165
Future income taxes	(Note 8)	35,860	15,913
SHAREHOLDERS' EQUITY			
Capital stock	(Note 9)	220,151	73,040
Contributed surplus	(Note 9)	1,094	331
Retained earnings		26,532	12,830
		247,777	86,201
Commitments	(Notes 9 and 11)		
Subsequent event	(Note 12)		
		$ 434,830	$ 139,925

See accompanying notes to the consolidated financial statements

Michael E.J. Phelps
Director
Calgary, Alberta
March 8, 2005

Gary F. Aitken
Director

CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS

For the years ended December 31,

($thousands)		2004	2003
			(restated, see Note 2)
Revenue			
Petroleum and natural gas		$125,604	$ 51,159
Less: royalties		26,526	9,436
		99,078	41,723
Expenses			
Production		23,556	8,636
General and administrative		6,819	3,369
Interest		2,532	517
Depletion, depreciation and accretion		42,846	13,340
		75,753	25,862
Income before taxes		23,325	15,861
Taxes	(Note 8)		
Future		8,978	5,335
Capital		645	204
		9,623	5,539
Net Income		13,702	10,322
Retained earnings beginning of year, as previously reported		12,830	2,439
Retained earnings adjustment, asset retirement obligation	(Note 2)	–	69
Retained earnings, end of year		$ 26,532	$ 12,830
Net income per share	(Note 9)		
Basic		$ 0.34	$ 0.41
Diluted		$ 0.32	$ 0.39

See accompanying notes to the consolidated financial statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31,

($thousands)	2004	2003 *(restated, see Note 2)*
Cash provided by (used in):		
Operating activities		
Net income	$ 13,702	$ 10,322
Items not involving cash		
Depletion, depreciation and accretion	42,846	13,340
Compensation expense	873	154
Future income taxes	8,978	5,335
	66,399	29,151
Asset retirement expenditures	(189)	(783)
Change in non-cash working capital	(14,807)	(7,513)
	51,403	20,855
Financing activities		
Issuance of common shares, net of costs	93,620	10,939
Equipment lease payments	(2,573)	(125)
Bank indebtedness	56,762	(4,295)
	147,809	6,519
Investing activities		
Capital expenditures	(135,174)	(34,496)
Disposition of petroleum and natural gas properties	10,668	1,543
Acquisition of petroleum and natural gas properties (Note 3)	(111,535)	–
Corporate acquisition costs (Note 3)	(400)	(800)
Change in non-cash working capital	31,318	8,944
	(205,123)	(24,809)
Change in cash and cash equivalents	(5,911)	2,565
Cash and cash equivalents, beginning of year	6,152	3,587
Cash and cash equivalents, end of year	$ 241	$ 6,152
Cash interest paid	$ 2,532	$ 517
Capital taxes paid	$ 160	$ 104

See accompanying notes to the consolidated financial statements

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2004 and 2003

(tabular amounts are stated in thousands or thousands of dollars except per share amounts)

NATURE OF OPERATIONS:

Fairborne Energy Ltd. (the "Company" or "Fairborne") is a resource-based company engaged in the exploration for, and the development and production of natural gas, natural gas liquids and crude oil in Western Canada. The Company was incorporated under the laws of the Province of Alberta on January 9, 2002 and commenced active operations with the purchase of certain petroleum and natural gas properties and equipment on May 31, 2002.

1. SIGNIFICANT ACCOUNTING POLICIES

a) Basis of presentation

The consolidated financial statements of the Company have been prepared by management in accordance with generally accepted accounting principles in Canada and they include the accounts of the Company and its wholly owned subsidiaries. All inter-company transactions have been eliminated.

b) Petroleum and natural gas operations

The Company follows the full cost method of accounting for petroleum and natural gas properties and facilities whereby all costs associated with the exploration for and development of petroleum and natural gas reserves are capitalized. Such costs include land acquisition costs, geological and geophysical costs, lease rental costs on non-producing properties, costs of both productive and unproductive drilling and production equipment. Gains or losses are not recognized upon disposition of petroleum and natural gas properties unless crediting the proceeds against accumulated costs would result in a change in the depletion rate of 20 percent or more.

The accumulated costs, less the costs of unproved properties, are depleted and depreciated using the unit-of-production method based on total proved reserves before royalties as determined by independent evaluators. Natural gas reserves and production are converted into equivalent barrels of oil based upon the estimated relative energy content.

The costs of acquiring and evaluating unproved properties are initially excluded from depletion calculations. These properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of impairment is added to the costs subject to depletion.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the years ended December 31, 2004 and 2003
(tabular amounts are stated in thousands or thousands of dollars except per share amounts)

1. SIGNIFICANT ACCOUNTING POLICIES *(Cont'd.)*

The Company places a limit on the carrying value of petroleum and natural gas properties and equipment, which may be depleted against revenues of future periods (the "ceiling test"). The carrying value is assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves, the lower of cost and market of unproved properties and the cost of major development projects exceeds the carrying value. When the carrying value is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value of assets exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves, the lower of cost and market of unproved properties and the cost of major development projects. The cash flows are estimated using expected future product prices and costs and are discounted using a risk-free interest rate.

c) Asset retirement obligations ("ARO")

The Company recognizes the fair value of ARO in the period in which it is incurred when a reasonable estimate of the fair value can be made. The fair value of the estimated ARO is recorded as a liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted on the unit-of-production method based on proved reserves. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is expensed to income in the period. Actual costs incurred upon the settlement of the ARO are charged against the ARO.

d) Interest in joint ventures

Substantially all of the Company's oil and gas exploration and development activities are conducted jointly with others and, accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

e) Goodwill

The Company records goodwill relating to acquisitions when the total purchase price exceeds the fair value of the net identifiable assets and liabilities acquired. Goodwill is assessed for impairment annually at year-end or if events occur that could result in an impairment. Impairment is recognized if the estimated fair value of the Company is less than the book value of the Company. If the fair value of the Company is less than the book value, impairment is measured by allocating the fair value to the identifiable assets and liabilities as if the Company had been acquired for a purchase price equal to its fair value. The excess of the fair value of the Company over the amounts assigned to the assets and liabilities is the fair value of the goodwill. Any excess of the book value of goodwill over this implied fair value of goodwill is the impairment amount. Impairment is charged to income in the period in which it occurs.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2004 and 2003

(tabular amounts are stated in thousands or thousands of dollars except per share amounts)

1. SIGNIFICANT ACCOUNTING POLICIES *(Cont'd.)*

f) Risk management

Financial instruments may be utilized by the Company to manage its exposure to commodity price fluctuations and foreign currency exposures. The Company's practice is not to utilize financial instruments for trading or speculative purposes.

The Company formally documents relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Company also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair value or cash flows of hedged items.

Foreign exchange gains and losses on foreign currency exchange swaps used to hedge US dollar denominated commodity contracts are recognized in income as a component of oil and gas sales during the same period as the corresponding hedged position.

The Company may use forwards, futures and swap contracts to manage its exposure to commodity price fluctuations. The net receipts or payments arising from these contracts are recognized in income as a component of oil and gas sales during the same period as the corresponding hedged position.

g) Stock-based compensation

The Company has a stock based compensation plan, which is described in Note 9. Compensation expense associated with the stock based compensation plan is recognized in income over the vesting period of the plan with a corresponding increase in contributed surplus. Compensation expense is based on the fair value of the stock based compensation at the date of the grant using a Black-Scholes option pricing model.

Any consideration received upon exercise of the stock based compensation together with the amount of non-cash compensation expense recognized in contributed surplus is recorded as an increase in capital stock.

h) Income taxes

The Company uses the liability method of accounting for future income taxes. Under the liability method, future income tax assets and liabilities are determined based on "temporary differences" (differences between the accounting basis and the tax basis of the assets and liabilities), and are measured using the currently enacted, or substantively enacted tax rates and laws expected to apply when these differences reverse. A valuation allowance is recorded against any future income tax assets if it is more likely than not that the asset will not be realized.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2004 and 2003

(tabular amounts are stated in thousands or thousands of dollars except per share amounts)

1. SIGNIFICANT ACCOUNTING POLICIES *(Cont'd.)*

i) Flow-through shares

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with tax legislation. A future tax liability is recognized upon the renunciation of tax pools and share capital is reduced by a corresponding amount.

j) Office furniture and equipment

Office furniture and equipment is stated at cost. Depreciation is provided on a declining balance basis at a rate of 20%.

k) Cash and cash equivalents

The Company considers cash and short term deposits with original maturities of three months or less as cash and cash equivalents.

l) Measurement uncertainty

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and revenue and expenses for the period then ended. Actual results could differ from those estimates.

The amounts recorded for depletion and depreciation and the provision for asset retirement obligations are based on estimates. The ceiling test calculation is based on estimates of proved and probable reserves, production rates, petroleum and natural gas prices, future costs and relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and may impact the consolidated financial statements of future periods.

m) Per share information

Basic per share amounts are calculated using the weighted average number of shares outstanding during the year. Diluted per share amounts are calculated based on the treasury-stock method, which assumes that any proceeds obtained on the exercise of in the money options and warrants would be used to purchase common shares at the average market price during the period. The weighted average number of shares outstanding is then adjusted by the net change.

n) Revenue recognition

Revenue from the sale of oil and natural gas is recognized when the product is delivered. Revenue from processing and other miscellaneous sources is recognized upon completion of the relevant service.

o) Comparative numbers

Certain of the comparative numbers have been restated to conform to the current year presentation.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2004 and 2003

(tabular amounts are stated in thousands or thousands of dollars except per share amounts)

2. CHANGES IN ACCOUNTING POLICIES

a) Full cost accounting guideline

Effective January 1, 2004, Fairborne adopted a new accounting standard relating to full cost accounting for oil and gas entities as described in Note 1(b). Prior to adopting the new standards, the ceiling test was based on the sum of the undiscounted cash flows expected from the production of proved reserves, the lower of cost or market of unproved properties and the cost of major development projects less the estimated future costs for administration, financing, asset retirement obligations and income taxes.

There were no changes to net income, petroleum and natural gas properties and equipment or any other reported amounts in the financial statements as a result of adopting the standard.

b) Asset retirement obligations ("ARO")

Effective January 1, 2004, Fairborne retroactively adopted, with restatement of prior periods, a new accounting standard relating to asset retirement obligations as described in Note 1(c). Prior to adopting the standard, Fairborne recognized a provision for future site restoration costs over the life of the oil and gas properties and facilities using a unit of production method.

The effect of adopting the new ARO accounting standard is presented below as increases (decreases):

BALANCE SHEET

As at December 31,	2003	2002
Net asset retirement costs, included in fixed assets	3,740	3,158
Asset retirement obligations	6,165	4,135
Accumulated provision for future site restoration	(2,764)	(1,086)
Future income taxes	122	40
Retained earnings	217	69

STATEMENT OF OPERATIONS

Year ended December 31,	2004	2003
Accretion expense	918	558
Depletion and depreciation on asset retirement costs	1,083	619
Future site restoration expense	(3,835)	(1,405)
Future income taxes	660	82
Net income impact	1,174	146
Per share impact		
Basic	$ 0.03	$ 0.01
Diluted	$ 0.03	$ 0.01

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2004 and 2003

(tabular amounts are stated in thousands or thousands of dollars except per share amounts)

2. CHANGES IN ACCOUNTING POLICIES *(Cont'd.)*

c) Flow through shares

Effective March 16, 2004, Fairborne prospectively adopted a new accounting standard for flow-through shares as described in Note 1(i). Prior to adopting this standard, the future tax liability associated with flow-through shares was recorded when the shares were issued. There were no changes to net income, or any other reported amounts in the financial statements as a result of adopting the standard.

3. ACQUISITIONS

On July 27, 2004 the Company acquired all of the outstanding shares of Case Resources Inc. ("Case") pursuant to an Arrangement Agreement dated June 25, 2004 between Case and Fairborne. Case was a publicly traded oil and gas company with properties located in western Canada. As consideration for the transaction, Case shareholders received 0.0909 of a Fairborne common share for each Case common share held. Fairborne issued 5.4 million shares to acquire Case at a deemed value of $51.5 million, based on the trading price of Fairborne shares on or about the date of acquisition. The results of operations for Case have been included in Fairborne's financial statements beginning July 27, 2004. Details of the acquisition are as follows:

Cost of acquisition:	
Shares	$ 51,518
Transaction costs	400
	$ 51,918
Allocated:	
Current assets	$ 1,443
Petroleum and natural gas properties and equipment	68,121
Goodwill (no tax base)	9,810
Current liabilities	(1,003)
Bank debt	(12,516)
Asset retirement obligations	(1,105)
Future income taxes	(12,832)
	$ 51,918

On March 31, 2004, the Company acquired certain petroleum and natural gas assets located in the West Pembina area of West Central Alberta. The acquisition has been accounted for by the purchase method. The results of operations from the assets acquired have been included in Fairborne's financial statements beginning March 31, 2004. Details of the acquisition are as follows:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2004 and 2003

(tabular amounts are stated in thousands or thousands of dollars except per share amounts)

3. ACQUISITIONS *(Cont'd.)*

Cost of acquisition:	
Petroleum and natural gas properties and equipment	$115,904
Asset retirement obligations	(4,664)
	$111,240
Allocated:	
Cash	$ 71,907
Cash from private placement of common shares	38,859
Transaction costs	474
	$111,240

On July 2, 2003 the shareholders of the Company and Pivotal Energy Ltd. ("Pivotal") approved an Arrangement Agreement to merge the two companies and continue as a publicly listed company named Fairborne Energy Ltd. As consideration for the transaction, Pivotal shareholders received 0.485 of a Fairborne common share for each Pivotal common share held. In addition, options to acquire Pivotal shares were exchanged for 778,162 options to acquire Fairborne shares. Upon closing of the arrangement, Fairborne had approximately 30.3 million common shares outstanding, of which prior Fairborne shareholders held approximately 65% of outstanding common shares and prior shareholders of Pivotal held approximately 35%. As such, the transaction was accounted for as an acquisition of Pivotal by Fairborne. The results of operations for Pivotal have been included in Fairborne's financial statements beginning July 2, 2003. Details of the acquisition are as follows:

Cost of acquisition:	
Shares	$ 31,048
Transaction costs	800
Options	633
	$32,481
Allocated:	
Current assets	$ 3,976
Petroleum and natural gas properties and equipment	47,426
Goodwill (no tax base)	6,360
Current liabilities	(6,221)
Bank indebtedness	(12,236)
Asset retirement obligations	(1,055)
Future income taxes	(5,769)
	$32,481

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the years ended December 31, 2004 and 2003
(tabular amounts are stated in thousands or thousands of dollars except per share amounts)

4. CAPITAL ASSETS

	2004	2003
Petroleum and natural gas properties and equipment	$ 436,826	$127,902
Corporate assets	1,032	607
	437,858	128,509
Accumulated depletion and depreciation	(59,137)	(17,219)
	$ 378,721	$ 111,290

Fairborne performed a ceiling test calculation at December 31, 2003 and December 31, 2004 to assess the recoverable value of petroleum and natural gas properties and equipment. The oil and gas future prices for the December 31, 2004 ceiling test are based on the January 1, 2005 commodity price forecast of our independent reserve evaluators. These prices have been adjusted for commodity price differentials specific to Fairborne. The following table summarizes the benchmark prices used in the ceiling test calculation. Based on these assumptions, the undiscounted value of future net revenues from Fairborne's proved reserves exceeded the carrying value of petroleum and natural gas properties and equipment at December 31, 2004.

Year	WTI Oil ($U.S./Bbl)	Foreign Exchange Rate	Edmonton Light Crude Oil ($Cdn/Bbl)	AECO Gas ($Cdn/mmbtu)
2005	42.00	0.82	50.25	6.60
2006	40.00	0.82	47.75	6.35
2007	38.00	0.82	45.50	6.15
2008	36.00	0.82	43.25	6.00
2009	34.00	0.82	40.75	6.00
2010-2012	33.00	0.82	39.50	6.00
2013	33.50	0.82	40.00	6.10
2014	34.00	0.82	40.75	6.20
2015	34.50	0.82	41.25	6.30
Escalate thereafter 2.0% per year				

As at December 31, 2004, costs of acquiring unproved properties in the amount of $31.2 million (2003 - $9.7 million) were excluded from the depletion calculation. Included in the Company's petroleum and natural gas properties and equipment balance is $7.9 million (2003 - $3.8 million) relating to asset retirement obligation, net of accumulated depletion.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2004 and 2003

(tabular amounts are stated in thousands or thousands of dollars except per share amounts)

5. EQUIPMENT LEASE

The Company repaid the equipment lease in April 2004. Prior thereto, the lease was payable in monthly installments of $29,977, including interest at 8.9%.

6. BANK INDEBTEDNESS

At December 31, 2004 the Company had available $125 million of demand operating credit facilities from two Canadian chartered banks subject to the bank's valuation of the Company's petroleum and natural gas properties. The facilities bear interest at the bank's prime rate or at prevailing banker's acceptance rates plus an applicable bank fee depending on the nature of the advance. At December 31, 2004 $77.2 million was drawn under the facilities. The scheduled review date of the facilities is May 30, 2005. The facilities are secured by a first ranking floating charge on all real property of the Company and a general security agreement.

7. ASSET RETIREMENT OBLIGATIONS

The Company's asset retirement obligations result from net ownership interests in petroleum and natural gas assets including well site, gathering systems and processing facilities. The Company estimated the total undiscounted amount required to settle its asset retirement obligations to be approximately $44 million (2003 – $22 million) which is scheduled to be incurred between 2014 and 2034. The majority of the costs are scheduled to be incurred between 2014 and 2020. A credit-adjusted risk-free interest rate of 8.5 percent and an inflation rate of 1.5 percent was used to calculate the fair value of the asset retirement obligations.

A reconciliation of the asset retirement obligations is provided below:

Year ended December 31,	2004	2003
Balance, beginning of year	$ 6,165	$ 4,135
Acquisitions	5,769	1,055
Liabilities incurred	1,176	1,200
Dispositions	(643)	–
Liabilities settled	(189)	(783)
Accretion expense	918	558
Balance, end of year	$ 13,196	$ 6,165

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the years ended December 31, 2004 and 2003
(tabular amounts are stated in thousands or thousands of dollars except per share amounts)

8. FUTURE INCOME TAXES

The provision for income taxes in the financial statements differs from the result, which would have been obtained in applying the combined federal and provincial tax rate to the Company's earnings before income taxes. The difference results from the following items:

	2004	2003
Earnings before taxes	$ 23,325	$ 15,861
Combined federal and provincial tax rate	38.62%	40.62%
Computed "expected" income tax expense	9,008	6,443
Increase (decrease) in income taxes resulting from:		
Non-deductible crown charges	6,021	2,037
Non-deductible stock based compensation	337	63
Resource allowance	(6,313)	(2,738)
Effect of changes in tax rates	(346)	(879)
Other	271	409
Future income taxes	8,978	5,335
Capital taxes	645	204
Total taxes	$ 9,623	$ 5,539

The components of the future income tax liability at December 31, 2004 and 2003 are as follows:

	2004	2003
Future income tax liabilities:		
Petroleum and natural gas properties and equipment	$ 43,475	$ 17,552
Future income tax assets:		
Asset retirement obligations	(4,519)	(839)
Share issue costs	(1,898)	(800)
Loss carryforwards (expire 2006 to 2011)	(1,198)	–
	(7,615)	(1,639)
Net future income tax liability	$ 35,860	$ 15,913

9. CAPITAL STOCK

a) Authorized

(i) Unlimited number of common shares; and

(ii) Unlimited number of preferred shares, issuable in series, rights and privileges to be determined upon issue, of which none have been issued.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2004 and 2003

(tabular amounts are stated in thousands or thousands of dollars except per share amounts)

9. CAPITAL STOCK *(Cont'd.)*

b) **Common shares, issued and outstanding**

	2004 Number of Shares	2004 Amount	2003 Number of Shares	2003 Amount
Balance, beginning of period	32,328	$ 73,040	19,750	$ 34,437
Issued for cash	8,903	72,421	–	–
Issued on acquisition of Case (Note 3)	5,423	51,518	–	–
Flow-through shares issued for cash	1,922	24,669	1,500	10,125
Issued on exercise of options	626	1,741	501	1,807
Issued on acquisition of Pivotal (Note 3)	–	–	10,577	31,048
Share issue costs	–	(5,101)	–	(590)
Future tax benefit of issue costs	–	1,863	–	224
Future tax impact of flow-through shares	–	–	–	(4,011)
	49,202	$220,151	32,328	$ 73,040

Common shares issued during 2004 included shares issued to directors and officers of the Company as follows: 58,950 flow-through shares issued for cash; 20,000 common shares issued for cash; and 483,000 common shares issued on the exercise of options.

In conjunction with the acquisition of Pivotal on July 2, 2003, all existing Fairborne common shares and Class A common shares were converted into new common shares of Fairborne.

Fairborne is required to spend $24.7 million on qualifying Canadian exploration expenditures pursuant to flow-through share issues in August 2004 and December 2004. Of the required expenditures, $17.3 million were incurred prior to December 31, 2004 and the remaining $7.4 million must be incurred prior to December 31, 2005.

c) **Contributed surplus**

	2004	2003
Balance, beginning of year	$ 331	$ –
Options granted	880	154
Options issued on acquisition of Pivotal (Note 3)	–	633
Options exercised	(110)	(403)
Options cancelled and expired	(7)	(53)
	$ 1,094	$ 331

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the years ended December 31, 2004 and 2003
(tabular amounts are stated in thousands or thousands of dollars except per share amounts)

9. CAPITAL STOCK *(Cont'd.)*

The weighted average fair value of stock options granted in 2004 was $2.44 per option (2003 - $2.90 per option) using the Black-Scholes option pricing model with the following weighted average assumptions: risk free rate of 4 percent (2003 - 4 per cent), expected volatility of 30-40 percent (2003 - 30 per cent) and expected life of three years (2003 - three years).

d) Per share amounts

The following table summarizes the weighted average common shares used in calculating net income per share:

	2004	2003
Basic	40,293	25,178
Diluted	43,213	26,424

The reconciling item between the basic and diluted average common shares are outstanding stock options and warrants. Excluded from the diluted number of common shares are 1,351,000 stock options (2003 – 176,889) which are out-of-the-money based on the fourth quarter average trading price.

e) Stock options

There are 3,624,583 stock options outstanding at December 31, 2004 with a weighted average exercise price of $5.40 per share. Options vest evenly over a three year period and expire five years from the date of grant. The outstanding options expire between January 23, 2006 and December 16, 2009.

The following table sets forth a reconciliation of the stock option plan activity for the years ended December 31, 2004 and 2003:

	2004		2003	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
Outstanding, beginning of year	2,861	$ 2.90	1,903	$ 2.40
Granted	1,395	$ 9.29	759	$ 4.17
Options issued on acquisition of Pivotal (Note 3)	–	$ –	778	$ 3.10
Exercised	(626)	$ 2.61	(501)	$ 2.80
Expired and cancelled	(6)	$ 10.20	(78)	$ 5.82
Outstanding, end of year	3,624	$ 5.40	2,861	$ 2.90
Exercisable, end of year	1,098	$ 2.76	841	$ 2.52

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2004 and 2003

(tabular amounts are stated in thousands or thousands of dollars except per share amounts)

9. CAPITAL STOCK *(Cont'd.)*

The following table summarizes stock options outstanding under the plan at December 31, 2004:

Exercise Price	Options Outstanding	Remaining Term (years)	Options Exercisable
$ 1.75	46	1.1	46
$ 2.40 - $ 3.09	1,555	2.5	874
$ 3.42	353	3.4	101
$ 5.20 -$ 5.92	354	3.0	77
$ 8.00 -$ 11.90	1,316	4.0	–
	3,624	3.4	1,098

f) Warrants

There are 1,960,000 warrants outstanding to purchase common shares at $3.50 per share exercisable at any time prior to close of business on May 31, 2006.

10. FINANCIAL INSTRUMENTS

a) Credit risk:

A significant portion of the Company's accounts receivable are from joint venture partners in the oil and gas industry and are subject to normal industry credit risks.

b) Fair value of financial instruments:

The carrying value of the Company's financial instruments, other than bank indebtedness, approximate their fair value due to their short maturity. The fair value of the bank indebtedness approximates its carrying value as it bears interest at a floating rate.

c) Forward sales contracts:

The Company has a price risk management program whereby the Company sells forward a portion of its future production through fixed price physical sales contracts with customers. At December 31, 2004, Fairborne had two fixed price physical sales contracts outstanding, one contract for crude oil and one contract for natural gas.

The crude oil contract is for 1,000 Bbls per day from January 1, 2005 to March 31, 2005 at a price of WTI US$34.70.

The natural gas contract is for 10,000 GJ per day from February 1, 2005 to March 31, 2005 at a price of CDN$6.50 per GJ plus 50 percent of the AECO C Monthly Index over $6.50 with a floor of CDN$6.50 per GJ.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
For the years ended December 31, 2004 and 2003
(tabular amounts are stated in thousands or thousands of dollars except per share amounts)

11. COMMITMENTS

The Company has certain lease commitments for its office premises through to September 30, 2008. As at December 31, 2004 the payments due under these commitments are approximately:

Year	
2005	$ 460
2006	$ 460
2007	$ 460
2008	$ 345

12. SUBSEQUENT EVENT

On March 8, 2005 the Company's Board of Directors unanimously approved a proposal to create Fairborne Energy Trust (the "Trust"), a new oil and gas trust and a public exploration-focused junior producer, Fairquest Energy Limited ("Fairquest") pursuant to a Plan of Arrangement (the "Arrangement"). Upon completion of the Arrangement, shareholders of Fairborne will receive one trust unit of Fairborne Energy Trust (or exchangeable share subject to a maximum number of exchangeable shares being issued) and one third of a share in Fairquest for each Fairborne share held. An information circular detailing the Arrangement is scheduled to be mailed to security holders in April 2005. A meeting of security holders to consider the reorganization is scheduled to occur in late May 2005. The Plan of Arrangement will require the approval of $66^{2}/3$ percent of the votes cast by the shareholders and optionholders of Fairborne voting at the security holder meeting as a single class and the approval of the majority of the shareholders excluding certain related parties. In addition, the approval of the Court of Queen's Bench and certain regulatory agencies will also be required.

SHAREHOLDER INFORMATION

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National Bank of Canada

LEGAL COUNSEL

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STOCK EXCHANGE LISTING

The Toronto Stock Exchange

Trading Symbol: **FEL**

CORPORATE GOVERNANCE

A system of corporate governance for Fairborne has been established to provide the Board of Directors, management and shareholders of the Corporation with effective governance. A more detailed discussion of corporate governance is available in the Information Circular for the Annual and Special General Meeting of Shareholders.

Shareholders and interested investors are encouraged to visit our web site:
http://www.fairborne-energy.com
Historical public documents, corporate information, latest presentation material and press releases are all available.
Filings also available at: www.sedar.com

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